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Full contents
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Past issues/regional covers
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NEWS ANALYSIS

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIED ADS

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E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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Print Edition February 16th 2002

The sadness of Japan
Is the high-growth country resigned to being high-sloth, forever? ... More on this week's lead article

Previous print editions
Feb 9th 2002
Feb 2nd 2002
Jan 26th 2002
Jan 19th 2002
Jan 12th 2002

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The world this week
Politics this week
Business this week

Leaders
Japan
The sadness of Japan

Europe's stability pact
Until next time

Iran, America and Europe
Means of persuasion

Energy liberalisation
It's good for you

Vaccines
The needle and the damage done

Letters
On Bjorn Lomborg

Special Report
Japan
The non-performing country

United States
Climate change
Blowing smoke

The defence budget
Transformation postponed

Faith-based institutions
Compassionate conservatism?

Mormon welfare schemes
Bishop's move

Trade policy
Romancing Big Steel

Indian business
Chips with everything

Campaign-finance reform
Soft money, tough measures

Lexington
The businessman as villain

The Americas
Drugs in the Andes
Spectres stir in Peru

Drugs in Bolivia
Leaves of discord

Venezuela's economy
Lenten diet

Argentina's crisis
Loaded dice

Mexico's border region
Opportunity lost

Asia
Systemic corruption
Something rotten in the state of China

The Koreas
Escape to the south

By broomstick to Tokyo
Potter's Japanese adventure

Malaysia's foreign workers
But who will do the dirty work?

Religion in India
Temple trouble

Opium futures
Rush to market

A survey of pensions
Time to grow up
P is for perfect
Snares and delusions
Hopeful Houdinis
Doing it their way
A matter of definition
Booting out equities
Time is running out
Acknowledgments
Offer to readers

Business
Energy trading
The ship that sank quietly

Corporate debt
The deadliest sin

Kirch
Going to pieces

Beauty treatments
Smooth face, big Botox

Japanese pharmaceuticals
Swallow the medicine

Tetra Laval
Boxed in

Mobile telephony in Africa
Wireless warriors

The future of computing
Let battle commence

Face value
A Turkish Rupert Murdoch

Finance & Economics
Financial regulation in America
Pitt the gamekeeper

Foreign-exchange losses
The ogre returns

The economics of envy
Rich-bashing

Credit-rating agencies
Quant argue with that

French banks and money-laundering
Operation screw the banks

Russia's economy
Scratch and sniff

America's current-account deficit
Wanted: $2 billion a day

Economics focus
Tax or trade

Science & Technology
Unnatural life
And now for something completely different

Particle physics
Radioactive disputes

Optical communications
Cutting the cable

Middle East & Africa

Yemen and its Islamists
Could Yemen's calm be threatened?

Israel and the Palestinians
Bombs and plans but no new faces

Madagascar's election
Sulking in his tent

Angola's war
From a scorched land, a hint of peace

Rwanda's genocide trials
When God was absent

Moroccan assassinations
The now unsecret policeman

Europe

France's presidential election
They're (just about) off!

A presidential also-may-run
A small white hope

Italy and corruption
Is there less than before?

The EU stability pact
Promises, promises, fudge, fudge

Power in Russia
The president's ear

Charlemagne
Zoran Djindjic and Balkan maps

Britain

Misspent youth
The naughty boy of Europe

Mercenaries
Mad Mike comes in from the cold

London's crime wave
Arise, Sir Rudy

Justice
The wrong man

Energy policy
New nukes or wind farms?

The economy
Rebalancing act

Education
Don't mention the V-word

Bagehot
Pop idols

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A rat exchange
LaboRATory dealings

Books & Arts

Victor Hugo
An interrupted sentence

New fiction
Coming home

George Soros
Philosopher manqué

Feminism
All the rage

Science and pregnancy
The flowering

European political history
Representative monarchy

Mountaineering
Cliffhanger

Classical pianists
Getting to the music's heart

Obituary

Princess Margaret

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Netherlands

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Exchange-rate forecasts

Emerging-Market Indicators

Overview

Stability index

Economy

Financial markets

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Terms of Reference IFC Private Enterprise Partnership Background ....

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Tenders

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Hashemite Kingdom of Jordan Ministry of Finance for Supply and Implementation ....

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Politics this week

Feb 14th 2002
From The Economist print edition

Denial on trial

Reuters

Yugoslavia's former ruler, **Slobodan Milosevic**, went on trial before a UN court at The Hague for the “almost medieval savagery and calculated cruelty” of Serb forces during ex-Yugoslavia's civil wars. The ex-dictator rejects the court's authority.

See article: Serbia's new leader, Zoran Djindjic

Refusing to back the European Commission, EU finance ministers agreed not to issue an “early warning” to **Germany** for having a prospective budget deficit near the limit, 3% of GDP, laid down by the EU's “stability pact”.

See article: The EU stability pact

Jacques Chirac formally declared himself a candidate for re-election to **France's** presidency. Voting day: April 21st, with a second round on May 5th, if need be.

See article: The French presidential campaign has begun

Another whiff of sleaze around **Britain's** Labour government: last July Tony Blair signed a letter to the Romanian government backing a deal to sell a state-owned steel firm to LNM, “a British company”, which in fact was registered in the Netherlands Antilles. Earlier, its Indian owner, Lakshmi Mittal, had given the Labour Party £125,000 ($179,000). Mr Blair also became the latest European leader to come under suspicion of dyeing his hair.

See article: Politics is boring, nothing wrong with that

Spain's government said it would legislate (as some provinces have already) to ban the drinking of alcohol in the street and raise the penalty for selling it to people under 18.

Russia's Orthodox church lambasted the Vatican for raising four “apostolic administrations” in Russia to the status of bishoprics. The Roman Catholics were after converts from Orthodoxy said Alexei II, Russia's patriarch.

The populist Northern League, a junior partner in **Italy's** government, threatened to walk out if it did not get a seat on the new board of RAI, the state broadcaster. Separately, the furthest left of three trade-union confederations urged the other two to join a general strike against “anti-labour” measures planned by the government. Humph, they said.

Floating not sinking

Defying pessimists, **Argentina's** peso floated rather than sank: freed for the first time in a decade, the peso traded at around 1.90 to the dollar. But the true test will come only once a partial freeze on bank deposits is lifted. By then, the government hopes to have IMF aid, having started talks with the Fund this week. Meanwhile, Uruguay's central bank took control of the local subsidiary of Banco de Galicia, a large Argentine bank, after a run on deposits.

See article: Floating Argentina's peso

Venezuela joined the currency flotilla. Confounding fears that he would impose exchange controls to stop capital flight, President Hugo Chavez, in an uncharacteristically moderate speech, said the previously-pegged bolivar would float (it promptly fell by 19%), and pledged to cut government spending.

See article: Venezuela's sagging economy

Peru's illegal-drug industry is reviving, partly because of spillovers from Plan Colombia. The United States said that a fall in coca production since the mid-1990s had halted; Peru and the UN both say coca and opium-poppy production is increasing.

See article: Drugs in the Andes

Pearl “dead”

Ahmed Omar Saeed Sheikh told a court in Karachi that he had kidnapped **Daniel Pearl**, an American reporter missing in Pakistan, and that he was dead.

The eight-man crew of an American military aircraft escaped without serious injury when it crashed in **Afghanistan**. Four other military aircraft are known to have come down since American action began in October. Nine Americans are reported killed.

The UN said its legal representatives had withdrawn from talks with the Cambodian government about bringing former members of the **Khmers Rouges** to justice. Under a recent Cambodian law some members of Pol Pot's regime could not be prosecuted.

America against the axis

Colin Powell, America's secretary of state, said that—contrary to any impression given by President George Bush's “**axis of evil**” speech—America had no plans to launch a war against anyone. However, he said, “regime change in Iraq would be in the best interests of the region”, and a number of options were being considered to bring that about.

See article: Iran, America and Europe

Mr Bush announced a plan to cut “**greenhouse-gas intensity**” by 18% over the next ten years and to give businesses incentives to invest in new technology. But he made no mention of carbon tax or carbon trading.

See article: George Bush's global-warming plan

The House of Representatives passed a sweeping bill to ban unregulated and “**soft money**” donations to political parties and to place new restrictions on broadcast advertising before elections. This, the first big campaign-finance reform since 1974, was not expected to deter fat-cats for long.

See article: Campaign-finance reform

Liberia's crackdown

Liberia's government, having declared a state of emergency after rebels attacked a town near the capital, Monrovia, embarked on a big round-up of suspects. A first batch of Sierra Leonean refugees returned home from Liberia under a UN voluntary-repatriation programme.

The row continued over monitoring **Zimbabwe's** coming election. An advance party of 30 EU observers, led by Pierre Schori, a Swede, arrived in Harare but the Zimbabwean government insists that it will allow only nine specified European countries to do the job and that Sweden is not among them. Abdusalami Abubakar, a former Nigerian head of state, who is leading a Commonwealth monitoring mission, said he could “see no problem”.

A protocol prohibiting the use of **child soldiers** came into force. It has so far been signed by 96 countries and been ratified by 14.

Protests and strikes over **Madagascar's** second-round presidential election looked a bit nearer solution when Amara Essy, the African Union's secretary-general, persuaded the incumbent and his main rival to talk to one another, and suggested that the election, due on February 24th, be postponed.

See article: Madagascar's disputed election result

The **Israeli-Palestinian conflict** raged on. After Hamas fighters killed two Israeli women soldiers and fired a homemade rocket from Gaza into northern Israel, Israeli jets bombed Gaza city and Israeli tanks raided the West Bank and Gaza.

Getty images

See article: Israel and the Palestinians

All 117 people on board were killed when an **Iranian aircraft** crashed into mountains on a domestic flight.

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Business this week

Feb 14th 2002
From The Economist print edition

Flying low

British Airways, on course for record losses, unveiled its latest attempt to deal with heavy debts, no-frills competitors, and the effects of September 11th and a foundering world economy. It will cut a further 5,800 jobs on top of the 7,200 cut last year (a quarter of the workforce, in total) and curtail its European short-haul operations.

The economic slowdown took its toll at **BP**. The British oil giant reported that profits had plunged in the fourth quarter by 46%, compared with a year ago, to $2.2 billion.

Anita and Gordon Roddick stepped aside from management roles at **Body Shop**, the ethically-aware health and beauty chain that they founded in the mid 1970s. Profit-aware investors have noted that the company's performance has suffered in recent years while competitors have prospered.

ABB reported its first-ever annual loss of $691m for 2001. The Swiss-Swedish engineering giant is also seeking reimbursement of generous pension payments to two former chief executives, including the respected Percy Barnevik, who formed ABB in 1988 and ran it until 1996.

NTL and **Telewest**, two British cable-TV broadcasters, are in discussion about a merger to create a national rival to Rupert Murdoch's BskyB. Liberty Media, an American cable concern which, together with Microsoft, owns Telewest, is looking for expansion opportunities in Europe after a rebuff by competition watchdogs in Germany over its attempts to buy up cable-TV stations there.

DuPont announced that it would spin off its textiles division, which includes Lycra, the legging material of choice to 1980s heavy rockers and fitness fanatics. The chemicals giant plans to concentrate on its core business by ridding itself of a division that both fashion and East Asian competition have rendered less profitable.

Bank insecurity

Allied Irish Banks admitted that it had drawn up plans to tighten trading controls over a year before a $750m loss suffered after a fraud by a foreign-exchange dealer, John Rusnak. It also revealed that suspicions about his activities had emerged a month ago.

See article: The ogre returns

The chief executive of **BSCH**, Spain's biggest bank, resigned. The departure of Angel Corcostegui is seen as confirmation that the real power in the bank is still Emilio Botin, the former boss of Banco Santander who is now chairman of BSCH.

Euronext, the merger of the Paris, Brussels and Amsterdam stock exchanges, made its latest move in the battle for European supremacy. A link-up with Warsaw's exchange follows just over a month after Lisbon's and Oporto's exchanges joined up. **Deutsche Börse**, a rival German exchange, was rumoured to be discussing similar deals with the stock exchanges of Milan and Madrid.

Lay silent

Ken Lay, **Enron's** former chief executive, appeared before a Senate hearing into the collapse of the

energy-trading company. Mr Lay exercised his right to avoid self-incrimination and said nothing other than that he was “deeply troubled”: that his silence would be perceived as an admission that he had something to hide, that is.

The post-Enron hunt for “unusual” accounting methods was joined by America's Securities and Exchange Commission. An investigation of **Global Crossing**, an American telecoms company that recently went into Chapter 11 bankruptcy protection, produced allegations that the company had engaged in “hollow swaps”; the trading of telecoms capacity that performed no other function than the artificial inflation of revenues.

See article: Financial regulation in America

Cable & Wireless, a leading British telecoms carrier, admitted swapping capacity with other telecoms companies. The company insisted that the accounting practice was legal as well as being normal in the industry because all the transactions had a commercial underpinning.

Nortel Networks parted company with Terry Hungle, its chief financial officer, amid accusations of insider trading. He resigned after it emerged that he had moved money in his personal retirement account, primarily comprising Nortel shares, shortly before sensitive company information was made public.

Selling up

American retail sales—excluding car sales that had surged before Christmas because of cheap financing—were up by 1.2% by value in January compared with December, as a buying spree continued. But consumers in Germany and Japan have tended to keep their hands in their pockets in the face of the slowing world economy.

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Japan

The sadness of Japan

Feb 14th 2002
From The Economist print edition

Is the high-growth country resigned to being high-sloth, forever?

Get article background

ANXIOUSLY, the world is waiting for signs that its biggest economy, America, is resuming its growth. Many are also wondering how strongly Europe's economies might grow this year, and whether that could help the rest of the world to revive the flows of trade and investment that were such a feature of the 1990s. No one, though, is wondering whether the world's second-biggest economy, Japan, might provide further assistance. For everyone knows that it will not: the only debate concerns how long and deep its recession will be. The charitable consider Japan an irrelevance. The less charitable see it as a liability. The panicky see it as a danger. Most Japanese simply shrug their shoulders.

Next Monday, February 18th, when President George Bush meets Japan's prime minister, Junichiro Koizumi, in Tokyo, the air will be thick with attempts to paper this over. From the Americans, there will be diplomatically phrased urgings that Japan should do more to reform its economy. From the Japanese government, there will be strenuous efforts to claim that reform is under way, that problems are being solved, that new measures are being considered. The claims will even be true, in a sense: there are plans aplenty, with stages and pillars and fine aspirations. But in a rather stronger sense they will be false: reforms are not being implemented, problems are not being solved, new measures are likely to make as little progress as the old ones. Japan is in a slow, so far genteel decline.

The reformer stymied

Perhaps the saddest thing is that there is nothing new about this. The turn in Japan's fortunes began in 1990 with the crash in its stock and property markets, and then took firm hold in the mid-1990s when banks started to crumble and public borrowing lost its ability to keep the economy growing. As long ago as September 26th 1998, *The Economist* lamented on its cover about “Japan's amazing ability to disappoint”. A canny Japanese parliamentarian interjected that we had got it wrong. The headline ought really to have read: “The Japanese people's amazing inability to be disappointed”. He had a point: despite all the country's troubles, the same old bunch—the Liberal Democratic Party—kept on being elected to run, or at least lead, the government.

Mr Koizumi's modest attempts at reform have been blocked, or put in the slow lane

That is why Mr Koizumi's entry to office last April came as a welcome sign of disappointment. He is also one of the old bunch, but a maverick who seemed to stand for change. He grabbed the party leadership by winning support at the grassroots, and secured remarkably high ratings in opinion polls. He helped his party do well in elections to the upper house of Japan's parliament last summer. His slogan suggested that he understood that the real problem was obstruction within his own party: “Change the LDP, change Japan!” So far, though, he has failed to solve that problem and therefore has failed to deliver any noticeable reform. His modest attempts have been blocked, or put in the slow lane. Since he sacked his popular (if erratic) foreign minister, Makiko Tanaka, last month, his poll ratings have fallen. That calls into doubt the one powerful card he has had up his sleeve: the threat of calling a general election and trying to make it, in effect, a referendum on reform.

The party dinosaurs are blocking his policies—on privatisation, bank clean-ups, administrative reform and deregulation—because change threatens the interest groups that vote for them, or finance them, or both. Another possibility should also be kept in mind, however. It is that the blockers realise that reform is not terribly popular with the general public, either. Voters may in principle like a man (or a woman, Ms Tanaka) who stands against the establishment, but as soon as it gets down to real policies that might cause real pain, they are naturally less keen. This has yet to be tested in a general election. But the old guard's hunch could well be right. Their best bet is to keep Mr Koizumi only so long as he remains popular, but meanwhile to stop him achieving anything.

No silver bullets

This apparent acceptance, among the general public as well as the political old guard, of a long, slow decline is rather sad for a once-vibrant nation, but not all that surprising. Life during the decline is by no means terrible: public services and infrastructure are good, people are affluent, families are strong. And the alternative is far from easy. There is no single solution to Japan's ills: neither a depreciating yen, nor monetary expansion by the Bank of Japan, nor fiscal reform, nor nationalisation of the banks, nor privatisation, nor deregulation, nor mass bankruptcies of zombie companies will bring Japan's economy leaping back to productive life. The government needs to do all of these, over a period of years, in order to reflate demand as well as reinvigorating private enterprise and restoring consumers' confidence (see article). All measures will be painful, in their different ways. How much easier it is simply to muddle through, slipping downhill more or less gracefully.

Which is why that is the likeliest thing to happen. Matters will turn out differently only if the Japanese public finds a new ability to become disappointed. That could occur in one of two ways: if a panic over bank deposits or a collapsing government-bond market makes them worried about their savings and determined to force change, rather as Argentines have done with their pots and pans; or if, in a general election, they finally kick out the old guard. Alas, either of these outcomes would bring with it the danger of opening the way to more extreme, nationalist political leaders such as Shintaro Ishihara, the foreigner-baiting governor of Tokyo.

It is not a pretty prospect. President Bush will know that Japan is not part of his “axis of evil”, and that it will support (discreetly) his efforts to constrain North Korea. But he should also note that, on current trends, Japan is going to be a drag on the world economy, not a help to it, that its efforts to depreciate the yen without embarking on real reform are liable to cause friction with its neighbours, especially China, and that there is some chance that its economy could genuinely collapse during the next few months and years. Japan now looks to be an irrelevance. Alas, it could well become a liability.

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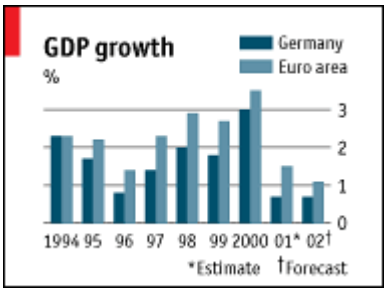
Europe's stability pact

Until next time

Feb 14th 2002
From The Economist print edition

Europe knows its fiscal rules have failed. Instead of fixing them, it fudged

GERMANY has been having difficulties over the European Union's “stability pact”. Thank goodness, everything has now been sorted out. It was all rather puzzling for those who were trying to follow events. Oddly, though, the financial markets were not in that group: they acted as if nothing had happened. Strange. What was all the fuss about?



The story followed a pattern seen before in EU affairs. Start by identifying a non-problem; pretend to solve it with a harmful non-remedy; when the drawbacks of the non-remedy become apparent, pretend to be confronting a crisis; finally, pretend to resolve the non-crisis with a new and somewhat less damaging non-remedy. Oh yes, and solemnly congratulate everyone on a triumph of unity and co-operation.

The initial non-problem was the idea that adopting the euro would encourage a binge of government borrowing. To be fair, this was not an entirely misplaced fear, but it was certainly much exaggerated. So long as any government which over-borrows knows that it will be denied a bail-out by the others (as the rules say it must be), it has good reasons to curb any such intentions—namely, the cost of servicing a bigger debt, and the fact that, if it really got carried away, financial markets would add a default premium to its bond yields.

However, unlike the non-problem, the non-remedy actually threatened to screw things up. The euro countries pledged to keep their deficits to less than 3% of GDP, except in a “severe” recession. That figure was too low, and allowed no leeway for the comparatively mild recession which Germany is now in. The stability pact stood to make fiscal policy contractionary in recessions. Stability requires doing the opposite.

Satisfyingly, it was Germany that insisted on the pact, and Germany that was first to demand it be set aside—hence the recent non-crisis (see article). With this week's agreement, the stability pact has now been either dismantled (if you believe Germany's business press and opposition politicians) or reaffirmed with useful improvements (if you believe European ministers and bureaucrats). In fact, it has not been dismantled, and it has not been improved very much either.

Europe's leaders declined to rebuke Germany for its fiscal recklessness (its budget deficit, by the way, with unemployment of 4m and rising, stands at just 2.7% of GDP), thereby setting aside the European Commission's advice and, it seems, the rules. They did this in return for Germany's promise to balance the budget by 2004. Perhaps the recovery will come soon enough, and be strong enough, to make that promise easy to keep. If not, Germany had better hope that its government is willing to break its word. Meanwhile, the stability pact stays in place—one is asked to applaud this steely resolve—guaranteeing that the recent muddle will sooner or later be repeated.

The fudged reaffirmation of the pact will make it impossible to abolish outright—which would probably be the best course—unless a real crisis makes that unavoidable. In the meantime, the wisest thing would be to keep improving and reaffirming it until it ceases to exist in all but name. The obvious way, and the easiest to square with the Union's insistence that something of the kind is needed, would be to cast the deficit ceiling explicitly in cyclically-adjusted terms. This would allow much more flexibility in acting to curb economic slowdowns whose effects are felt more severely in some parts of the EU than others. This week was a missed opportunity to do that simple thing. Rest assured, the issue will come up again.

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Iran, America and Europe

Means of persuasion

Feb 14th 2002
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How America and Europe, working together, might get Iran to do, or stop doing, certain things

SUBSCRIBING to the same aims does not entail accepting the same approach. The harsh language of George Bush's “axis of evil” speech has alarmed people, in Europe and elsewhere, who have qualms about the way that America has fired off at a three-country target: Iran, Iraq and North Korea. Chris Patten, the EU's commissioner for external affairs, fears that America could be taking the campaign against terrorism into “unilateralist overdrive”; Germany's foreign minister, Joschka Fischer, wonders at the point of putting those three countries in the same pot. In particular, European voices question the wisdom of casting Iran into that pot of sinners.

EPA

American-European differences over Iran have quite a history. Although the aims are roughly the same—to persuade Iran to desist from making trouble in its turbulent region and beyond, and to obey the arms-control treaties it has signed—the means of persuasion differ. The Europeans believe, not without a certain degree of self-interest, in talking and trading; the Americans in economic and diplomatic sanctions.

In truth, there is no conclusive evidence about the effect of either approach. For the past half-dozen years Iran has been convulsed by an internal power struggle between its elected government, under Muhammad Khatami, which is trying, by and large, to turn Iran into a more respectable place, and the powerful unelected cadres which, under the remote control of the supreme leader, Ayatollah Ali Khamenei, fight to preserve the structure and principles of the 1979 Islamist revolution.

The power struggle swings back and forth, as does the argument over how best to influence it. But, over the years, President Khatami has chalked up a number of incremental foreign-policy victories that probably owe more to European sweet talk than to American sternness. For instance, the regime no longer sets out to murder its dissident leaders living in western cities. It has stopped encouraging the murder of Salman Rushdie, a British writer who offended Muslim sensibilities. And it is less interested than it once was in stirring up trouble among Shia Muslims in such Sunni-run countries as Pakistan, Saudi Arabia or Bahrain. But it may have been the attitude of the United States that induced Iran to be helpful during the Afghan war, including its latest decision to close down the Iranian offices of a fundamentalist Pushtun leader, Gulbuddin Hakmatyar.

Iranian foreign policy may have got a bit better under Mr Khatami but there are still two lacunae. First, its support of terrorist groups; second, its covert weapons programmes. Judgment on the first hangs largely on the definition of “terrorism”. Iran strongly supports Hizbullah, a Lebanese faction that has certainly committed terrorist actions in the past but can also claim to be a national resistance movement. Questions remain, including a big one over that shipload of Iranian arms seized by Israel in the Red Sea last month. But it is still a longish step from local mischief-making to charging Iran with actively supporting anti-American international terrorism.

Iran's support for terrorist groups, and its covert weapons programme, are worrying

However, Europeans, no less than Americans, do suspect Iran of secretly acquiring weapons of mass destruction. This is a deeply disturbing prospect. Hedged around by well-armed, unfriendly countries and barely recovered from a war with Iraq that cost it several hundred thousand men, Iran acutely feels the need to defend itself. But as a signatory to the relevant treaties, it has promised not to acquire nuclear,

chemical or biological weapons. It must keep to—and be held to—that promise. Accepting tougher, internationally-approved nuclear checks, for instance, would be a way for Iran to show it is clean—and that it wants to improve its standing in the world.

The light beyond the dark

So back one comes to the question: is Iran best held to its word by Europe's “constructive engagement”, America's stand-off and threats, or a combination of the two? A combination, probably, but on two conditions. First, if the Americans and Europeans are to go in for sticks and carrots, they have to accept what the other is doing, rather than squabbling. Second, since by far the most tempting carrot is the one that America holds in its pocket—an easing of sanctions—it is crucial that the Americans themselves play the game.

With the thunder still reverberating from Mr Bush's attack, this may be a poor time to talk of rewards for better conduct. Some argue that the name-calling itself may shock Iranians into healthy rethinking. Good if it does, but it is at least as likely to stiffen Iran's defensiveness, making it readier to strike out. The continuing need is to strengthen Mr Khatami's hand, and it would do so immeasurably if he could detect an eventual sanctions-free day. Iranians take in the sins of the Great Satan with their revolutionary milk, but most are keener on the free-trade air that they hope one day will float in.

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Energy liberalisation

It's good for you

Feb 14th 2002
From The Economist print edition

An overlooked lesson from Enron is that energy deregulation works

SO MIXING energy and competitive markets is obviously crazy, is it? Coming on the heels of California's electricity crisis, says a chorus of anti-liberalisers, Enron's collapse surely kills off any notion that energy deregulation is a good idea.

No, it does not. Enron's failure was due to the vanity and villainy of its bosses, not to the vagaries of deregulation. The financial shenanigans that undid Enron are not unique to this industry—and should not be carelessly pinned on deregulation. On the contrary, it was the flexibility of energy markets which ensured that the collapse of the world's biggest energy trader did not result in a single power or gas disruption. For that, deregulation deserves credit (see article). Even so, it remains only a partial success story. Entrenched incumbents have been fighting to turn back the forces of liberalisation. Enron's demise should therefore be treated as a reason to bolster the shift towards more competitive energy markets.

Energy restructuring in America has been a half-baked affair, thanks to regulatory turf battles and the lack of the right federal framework. Small wonder that it produced a halfway house like California's, whose politicised electricity system was almost engineered for crisis. In Europe, although Britain and Scandinavia led the world in freeing energy markets, further reforms have stalled in the face of opposition from France and Germany. The danger is that consumers will be stuck with the worst aspects of deregulation but gain few of the benefits of competition. The way out is for politicians and regulators to accelerate, not to abandon, liberalisation.

Forge ahead

Paradoxically, that now means improving energy regulation, in three ways. The first is to toughen market surveillance. Despite protests to the contrary from free-market fundamentalists, deregulation, whether in energy or elsewhere, should not be equated with no regulation. As experience in Britain shows, competition in energy works only when there is a strong, if narrowly defined, role for an overall regulator.

That is why Congress should expand the supervisory powers of the Federal Energy Regulatory Commission to include government-run utilities, from the Tennessee Valley Authority to municipal ones, that now fall outside its remit. It should also give it the resources to crack down on utilities that obstruct access to their high-voltage lines to trade power. In Europe, the European Commission needs to ensure that dug-in oligopolists do not forever maintain control of both supply and distribution. It should also keep a vigilant eye on cross-border deals that threaten to turn the European market into a stitch-up for a few giants such as Electricité de France.

Governments should also do more to spur the development of energy markets. Enron may have been an unduly aggressive combatant, but most energy companies are actually pygmies who seek to avoid competition. America has a fragmented and inefficient utility industry; Germany has dozens of politically powerful municipal utilities. In America, Congress ought to dismantle obstacles to consolidation (such as the Public Utilities Holding Company Act, a Depression-era leftover) in gas and power, which are fast converging into one business. Germany should stop boosting national champions and create an independent regulator.

Third, fledgling energy markets need clearer and more consistent rules. Electricity markets are too fragmented: state and federal regulators squabble in America, and rules vary across Europe on such things as inter-connection to power grids. This discourages investment in such neglected areas as transmission lines and in promising new technologies such as fuel cells. The most important stimulus to such innovations would be an expansion of retail competition and choice.When market reforms are done properly, the results can be breathtaking. In Britain, competition in the retail market for gas and power is transferring over $2 billion a year from energy companies to their customers, including domestic households. Energy deregulation promises to produce a wave of innovation, investment and improvement in the stodgy utility business that could be as dramatic as the telecoms revolution that followed the break-up of AT&T. It would be disastrous if Enron's collapse were now misread as a reason to scrap the trend to more competitive energy markets.

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Vaccines

The needle and the damage done

Feb 14th 2002
From The Economist print edition

Governments have only themselves to blame if people don't believe what they say

Science Photo Library

LEO BLAIR has now been baptised into politics. The British prime minister's 21-month-old son has become the focus of a fuss over the combination commonly given to infants to protect them against measles, mumps and rubella (MMR), which has become controversial because of claims that it is linked to bowel disease and autism. Take-up is falling and measles is on the rise. The government is about to embark on an advertising campaign to boost MMR vaccines, yet Mr Blair, who in his ordinary-chap persona is normally happy to chat about "the kids", has refused to say whether or not Leo has had the jab; and the press has been badgering him on the ground that people have a right to know whether the First Parent has done what the government says is best for everybody.

Vaccines are the victims of their own success. Where the benefits of a technology are clear, consumers will put risks into perspective: people are so attached to their mobile phones, for example, that few have jettisoned them despite allegations of a link between mobile phone use and cancer. In the case of the MMR vaccine, however, few young parents in the rich world have seen a case of measles or rubella, but many know someone with autism. The risks of the vaccine are visible; its benefits are not.

Vaccine scares are not unique to Britain. Worries that the jabs for MMR may cause autism have spread to America, where some people believe the condition is also linked to a vaccine additive called thimerosal. Fears that hepatitis B vaccine might cause multiple sclerosis have restricted its use in France. Rumours that a tetanus vaccine may interfere with fertility led to its withdrawal in the Philippines and Nicaragua.

But the debate is more heated in Britain for a couple of reasons. Public confidence in pronouncements on public health by the government and the nation's big scientific cheeses has collapsed since the BSE crisis, when authorities assured the public that all was well and were proven spectacularly wrong. And, ironically, the government's drive towards less paternalism and more choice for patients is fuelling this debate, as more parents choose to ignore the government's advice and pay for their children to be immunised with three single vaccines, rather than the triple one.

In Britain, confidence in public-health pronouncements has collapsed since the BSE crisis

More choice is good, but it needs to be well-informed, and parents are placing more faith than they should in newspaper reports of the theories of a lone scientist. Many studies have failed to find a link between MMR vaccines and autism, a finding endorsed by the World Health Organisation. Far less evidence exists about the side-effects of a series of single vaccines, so there is no reason to assume that they are any safer. Anyway, the benefits of MMR immunisation vastly outweigh the risks: in Ireland, for instance, where the vaccination rate is lower than in Britain, in 2000 there were more than 1,600 measles cases and three deaths.

Nor can parents shun the MMR vaccine secure in the knowledge that everybody else's immunity will keep their children safe. In the 1970s, fears that the whooping cough vaccine caused brain damage cut immunisation rates by half. Three epidemics and 70 deaths ensued.

A matter of trust

For people to believe what the government says, they need to trust it; and Britain's government has abused public trust in the past. Its main task now is to rebuild its scientific credibility. It needs to ensure that all health-care workers, from general practitioners to midwives, are kept up to date with developments in the debate and learn how to discuss, rather than dismiss, parents' fears. It also needs to recruit independent bodies, such as patients' organisations and consumer groups, to support vaccination.

Making vaccination compulsory—as it is, in effect, in some countries—is out of the question in Britain right now. People are too suspicious. Still, the government could require those who choose not to accept vaccination to get a certificate of exemption before their children can attend school. That way, doctors would have the chance to change the minds of worried parents. If they can't, nature will do the job for them, after the epidemics have returned, and many children have died.

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Letters

Feb 14th 2002
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Bjorn Lomborg

SIR – As co-author of the review of "The Skeptical Environmentalist" in *Nature* and of a critique of its chapter on biodiversity published by the Union of Concerned Scientists, I must be one of the green heretics you refer to in your one-sided leader ("Defending science", February 2nd). You are smearing the vast majority of the scientific community. You say that the four senior scientists who attacked Bjorn Lomborg's polemic in *Scientific American* were "weak on substance". To show you how absurd this is, Professor Tom Lovejoy, who wrote the piece on biodiversity, is a senior ecologist and biodiversity adviser with the World Bank, and a leading authority on tropical ecology. Your attempt to discredit him is sordid and reflects your conservative ideological agenda.

I have not the space here to debunk the vast amounts of disinformation in Mr Lomborg's book. Its fatal flaw is to ignore the connection between environmental indicators and the condition of the underlying ecosystems upon which our survival (and that of all life) depends. Mr Lomborg says nothing about the fraying of marine and terrestrial food webs, the extent, loss and chemical alteration of wetlands, the effects of invasive species, etc.

I will conclude with a quotation from an article that appeared in *Jyllands-Posten,* a Danish Sunday paper:

> Ove Nathan, former president of the University of Copenhagen, thinks it totally unlikely that such a thing as a scientific conspiracy against Bjorn Lomborg should exist. "There is no scientific periodical that outshines or is more critically edited than , and In science they speak with almost the same authority as the Bible of Christianity and the Koran of Islam. If all three periodicals pass the same severe judgment upon Lomborg, I personally would take it for gospel truth."

Jeffrey Harvey
Netherlands Institute of Ecology
Heteren, Netherlands

SIR – Echoing Mr Lomborg, you dismiss the criticisms of *Scientific American*'s authors as insubstantial. *Nature* and *Science*, and a variety of scientific organisations, seem to disagree. They recognise that Mr Lomborg's book is an assault on science because investigators maintain that he is misrepresenting their work. But why believe them? As Mr Lomborg has argued, they are dishonest or too incompetent to understand their own research—only political scientists have a trustworthy grasp of environmental literature.

Mr Lomborg tries to hide his anti-scientific intent by saying that most researchers are doing good work, the true meaning of which is distorted by environmentalist hacks. One might imagine then that his message would be welcomed by legions of wronged researchers. Somehow they have failed to materialise.

You grant that Mr Lomborg's work "has its flaws", then casually refer to a list of failings that thoroughly undermine his argument. It is a pity that by telling a fairy story that so many want to hear, Mr Lomborg succeeds in fooling the public and in enticing *The Economist* to betray its usually excellent standards of science journalism.

John Rennie

Editor in chief
Scientific American
New York

SIR – One can agree that Mr Lomborg is mainly correct and still feel that your defence misses or downplays some important criticisms. On the possibility of irreversible calamities, for instance, you say that “risk argues for caution”. Should not caution mean basing policies on the worst ends of plausible projection ranges, rather than Mr Lomborg's statistically probable ones?

Also, you argue for trade-offs in “economic efficiency”, based on how much people are willing to spend for public goods (Economics focus, February 2nd). But we have no way of weighing impacts on our world ten or 100 generations from now. Discount the value of an environmental good that may exist 1,000 years from now, and the net present value is at or near zero. We should certainly discuss fairly the points Mr Lomborg makes, but much of your treatment calls to mind the fellow who asked: “Why should I care about posterity? What did posterity ever do for me?”

Stanford Taylor
Pasadena, California

SIR – Mr Lomborg is not a scientist, he is a statistician. The statistics he uses are based on an extremely selective reading of the data and widespread, and presumably deliberate, misinterpretation of decades of authoritative scientific work. Only in this way is he able to conclude the exact opposite of what everyone else—scientists and environmentalists alike—has long been saying about biodiversity, forests and climate change. That, by the way, is why I threw a pie at him.

Mark Lynas
Oxford

SIR – You note that many respected scientists support the position of environmental activists and that Mr Lomborg faces considerable criticism by members of the scientific community. This may be true about some topics but not all.

My colleague, S. Robert Lichter, and I surveyed a random sample of cancer epidemiologists, drawn from the American Association for Cancer Research, comparing their responses with those of environmentalists and newspaper coverage of the issues. (S. Robert Lichter and Stanley Rothman, “Environmental Cancer: A Political Disease?”, Yale University Press, 1999.) We found that scientists were far less likely to ascribe environmental cancer to man-made chemicals than were environmental activists. But a systematic analysis of media coverage, including the *New York Times*, showed that the issues were described as if the views of the activists were the views of the scientific community. It is true that some respected scientists hold views in accord with those of the activists on the etiology of environmental cancer. But those most respected by their colleagues are hostile to environmental activists' views, and the more work they have published in the field the more hostile they are.

Indeed, as we show, most scientists have little respect for activists or the media when it comes to reporting on areas of their expertise. Not surprisingly, they are less likely to be quoted or cited in the media than scientists whose views journalists share. Mr Lomborg may have more support among scientists than is immediately apparent.

Stanley Rothman
Smith College
Northampton, Massachusetts

SIR – The extraordinary fury inspired by Mr Lomborg shows that the institutions of science have devolved into “The Scientific Institution”, which not only wields political power but also aims at suppressing freedom of thought. Sir Karl Popper said that “scientific theories are distinguished from myths merely in being criticisable, and in being open to modifications in the light of criticism.”

Pascal Leroy
Dilbeek, Belgium

SIR – That scientists make crass, dishonourable attacks on Mr Lomborg is probably a result of the market-driven environment in which much of science is practised. The struggle to obtain funding from politically-based organisations has led most scientists to a “publish or die” policy: those who make the

most noise get the money. This behaviour corrupts those who apply it and leads them to value the defence of their funding more than the merits of their science.

David Goldblatt
Geneva

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About sponsorship

Japan

The non-performing country

Feb 14th 2002 | TOKYO
From The Economist print edition

AP

If Japan does not write off its bad loans, will the world write off Japan?

Get article background

WHEN George Bush and Junichiro Koizumi met in Washington last June, it was the American president who seemed the more politically insecure and the Japanese prime minister who was riding high. Now, as they prepare to meet in Tokyo next week, their positions seem to be reversed. Mr Bush looks more sure-footed than he did last summer, and he has the kind of sky-high public approval once enjoyed by his Japanese counterpart. Mr Koizumi's fall from grace, meanwhile, has been swift and stunning. Since he sacked his popular foreign minister last month, his poll numbers have plunged. Worse, Mr Koizumi's plight may make him more helpless than ever against Japan's triple menace of debt, deflation and political deadlock.

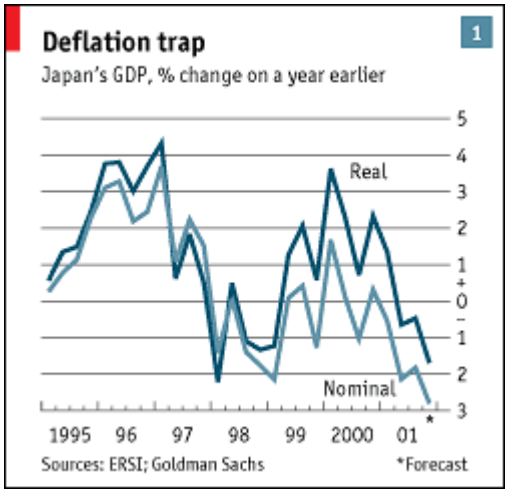
That is why Mr Bush's anti-terrorism campaign will not seem the most pressing issue when he arrives on February 17th, starting a week-long tour of Japan, South Korea and China. Of course, Mr Bush will want to discuss the regime in North Korea, which he has recently fingered as a member of his “axis of evil”. He will also praise Japan for sending support ships to the Indian Ocean to help America in the Afghanistan campaign. But all eyes next week will be on Japan's economic slide, and on Mr Koizumi's newest set of promises—to be unveiled for Mr Bush's benefit—that he will do something about it.

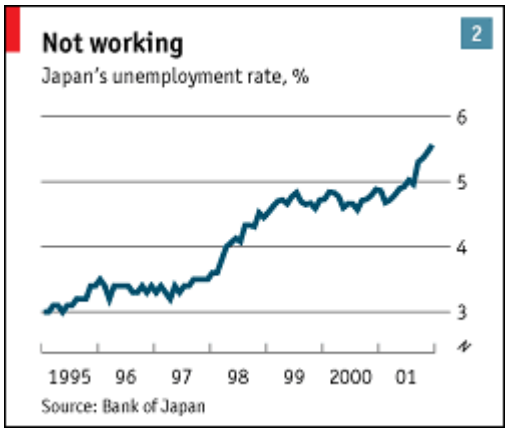
When Mr Bush comes to visit, all eyes will be on Japan's economic slide

Those glancing in from a distance may find it hard to tell Japan's current mess from the general doom and gloom of the past decade. But people watching more closely see three especially strong reasons to tremble now. The first is that deflation and depressed spending continue unabated, bringing fears of an accelerating downward spiral. Consumer prices have fallen every month for more than two years. Retail sales have fallen for more than three years, and were down by nearly 6% in the year to December. GDP is once again falling in real terms; nominal GDP is falling even faster (see chart 1).

Only a few months ago many Japanese economists were still saying that Japan's deflation might be healthy, since lower prices make life better for consumers. Those optimists have gone silent, however, as falling prices have continued to be matched by dwindling jobs. Japan's unemployment rate rose to 5.6% in December, the highest since the second world war and nearly a percentage point above the rate a year ago (see chart 2). More

than a million heads of Japanese households are now out of work.





The job losses follow collapsing balance sheets at weak Japanese companies, as falling prices squeeze profits and make it harder for them to service their debts. More than 19,000 companies went bankrupt last year, many of them small and mid-sized suppliers feeding Japan's bigger conglomerates.

Worse, the job cuts keep accumulating. Successive waves of lay-offs eat further into national income and confidence, hampering household spending and sending slightly healthier firms to the wall. Last year, such well-known corporate giants as Fujitsu, Hitachi and Toshiba announced massive cuts in employment as their profits collapsed. These were matched by countless smaller lay-offs at less well-known Japanese firms.

Banking blues

This deflationary trend is one reason why informed observers now feel so jittery. A second reason stems from Japan's rickety banking system (a natural consequence of all those indebted companies), and from the common knowledge that the government must one day accept that it will have to do more to deal with the burden of banks' bad loans. Although this has been obvious for years, a confluence of coming events has persuaded many investors that the day of reckoning is near.

On April 1st, Japan will start a new financial year, which this time round will set off a pair of decisive changes. Banks, which own lots of Japanese equities, will be made to value these shares at market prices. Because equity prices have fallen sharply since the shares were bought, the banks will have to show losses of more than one-and-a-quarter times their operating profits. Although those losses have already occurred, admitting to them could cause fresh problems if it prompts more depositors or investors to flee.

Depositors are anyway nervous, because of another change due on April 1st. After putting it off last year, the government will finally begin rolling back the blanket deposit insurance that it introduced in 1998. The first stage will affect only time deposits, and will limit insurance to ¥10m ($75,200) per depositor at each bank in which the person or institution holds an account. Many depositors have already moved their money, spreading it around in ¥10m instalments and transferring much of the rest into other types of deposits, which will remain insured for another year. The risk remains that the partial repeal will cause bank runs. Some Japanese have been buying gold for safety.

These looming changes, by raising the odds that Japan's long-awaited crisis will at last arrive, leading to some kind of economic meltdown that could be cathartic but might be disastrous, have helped to send asset prices tumbling. Share prices have fallen yet again, to their lowest levels since the mid-1980s. The Nikkei 225 stockmarket average, which in its proudest moment in 1989 approached 40,000, now languishes at around 10,000 (see chart 3).

Worse will follow if bond investors come to share the alarm. So far they have been subdued, keeping the government's debt-service payments in check. But, after running up fiscal deficits throughout the past decade's slump, Japan's official public debt has risen to 130% of GDP. Even the fuzziest maths cannot disguise that the real problem is much worse. For a start, Japan's deflation is causing nominal GDP to shrink, driving up the debt-to-GDP ratio even without any new spending. Add to that a continuing annual deficit, to avoid adding fiscal contraction to the economy's other woes, and the debt ratio will go on rising. The budget that Mr Koizumi wants to pass, which is modest by his ruling party's

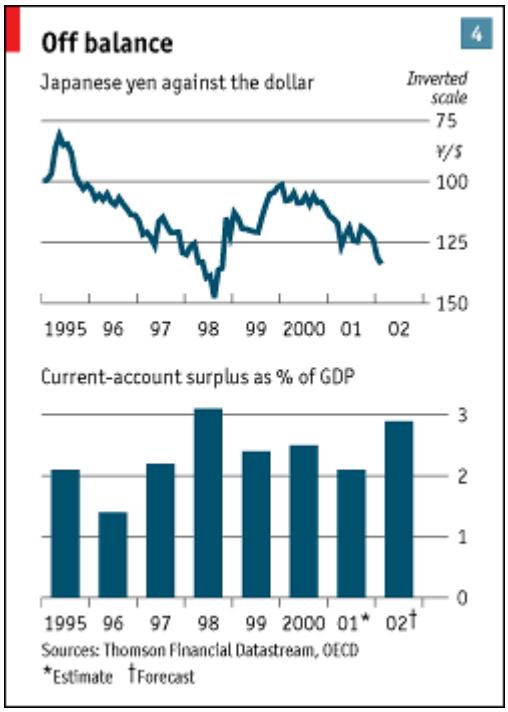
standards, will easily drive the ratio above 140% within a year.

None of this includes the cost of the government's other liabilities, stemming from publicly-backed corporations, social-security promises, and, if it is forced to nationalise the banks, the cost of cleaning up their balance sheets. Japan's fiscal position is, in short, pretty dreadful. This has already prompted downgrades by the rating agencies: this week, Moody's said it might lower Japan's credit rating to the same levels as Poland and South Africa. The only blessing is that foreigners hold little of the government's debt, which may still allow it to postpone a bond-market panic.

Thus both the pace of economic deflation and the risk of financial implosion seem to have gone up a notch or two lately. But neither of these threats is new. And, even if the risks are now higher, Japan might still find a way to muddle through and delay any real crunch—as it has managed to do for most of the past ten years.

Even those onlookers who still downplay the situation are fretting, however, for a third reason. Unlike most previous bouts of panic over Japan, they fear, this one has far more potential to cause trouble in the rest of the world. With much of East Asia still in recession, and an American recovery still shaky and uncertain, an implosion of what is still the world's second-biggest economy could seriously damage the global economy. Japan remains a big trader, investor and lender, so any collapse would affect all its counterparties. And even if Japan pursues mild efforts to avoid it, its trading partners, especially in the rest of Asia, will still share its pain.

The most visible sign of this risk is the yen, which began sliding towards the end of last year. It has recently settled down, hovering around 133 to the dollar (see chart 4). But even that has prompted outcries from Japan's East Asian neighbours, as well as from the United States. America's big car makers petitioned Mr Bush, apparently with little success, to put their troubles with Japanese rivals on the agenda of his meeting with Mr Koizumi. Last month America's treasury secretary, Paul O'Neill, also delivered a mild rebuke while he was in Tokyo, by urging Japan not to drive its currency down at the expense of other “reforms”.



Reform, reflate or both

Mr O'Neill thus plunged headlong into a contentious and confused debate that has plagued Japan for years: reflate first and reform later? Or vice versa? Or just reflate? A simple dispute over this is hardly the crux of the problem. Vested interests—among the bureaucracy, the politicians of the ruling Liberal Democratic Party (LDP) and the disproportionately powerful voting blocks that back it—are clearly the prime culprits. These groups benefit in some ways from Japan's malaise, especially from the fiscal gravy train that has rattled along unhindered throughout the slump. Just as important, these factions are perennially battling each other, over which of them should bear the shame and financial costs of fixing the problem.

Japan's vested interests do not merely frustrate reform through unpopular votes in the Diet, Japan's parliament. They also command much of the machinery through which ideas are evaluated and turned into legislation. If a prime minister wants to challenge them, he has little chance of even bringing a good alternative up for a vote. That makes it harder for the Japanese voters to vet recovery plans clearly, and

make their wishes known. When combined with backroom dealing, lacklustre mass media and the cacophony of factional battles, this had made it all but impossible for any plan to achieve a consensus. And, when there is no consensus, Japan tends to revert to autopilot.

Politically, therefore, Japan would find it hard to recover even if disinterested experts could agree on what it should do. Yet, even without worrying about who wins and loses, economic analysts continue to bicker among themselves over the answer. All agree, however, on Japan's need to inflate its way out of trouble. Its private and public debts are enormous. Falling prices make almost everything worse. Any effort to tackle Japan's numerous other problems will require much more borrowing or take another big chunk out of domestic demand. There is no realistic way forward, therefore, without steps to get Japanese prices rising, preferably by several percentage points a year. This would not only boost nominal demand, but would lower the public and private debt burden in real, inflation-adjusted, terms.

Unfortunately, a collapsed asset bubble followed by years of inaction have made it hard for Japan to achieve inflation, since expectations of flat or falling prices are so entrenched. With short-term interest rates at zero, the Bank of Japan has tried to loosen things further through “quantitative easing”, making more funds available to banks. But that has done little to boost broad-money supply; bank lending has been falling inexorably for four years.

Technocrats debate ways to fix this problem. One approach is to get the banks to finance Japan's fiscal deficit directly, bypassing the bond markets. Another is to print yen and use them to buy up foreign bonds. But most economists agree that, if Japan is to achieve inflation, the yen will have to fall much further, perhaps to between 180 and 200 to the dollar.

What about structural reform? Should it wait for inflation or be done in parallel? Various groups are juggling different reform plans to fix Japan's “structural problems” and help restore growth. There is certainly a risk that harsh supply-side reforms would, on their own, make things worse, rather as they did in American in the 1930s; Japan's chief problem is shortage of demand, even though some demand may be suppressed by supply-side problems. So the most sensible option is to work in parallel with inflation, to the extent that Japan can achieve it. The prime candidates for reform are Japan's insolvent banks, along with their mirror reflections, overly indebted companies.

Along with slumping demand, Japan is now beset by overcapacity in many industries, such as construction and retailing. Many of these companies can never be profitable, but because the banks continue to prop them up they can avoid going bust. As they continue to cling on, meanwhile, the walking dead drive down prices and capture business from healthier rivals.

Along with slumping demand, Japan is now beset by overcapacity in many industries

Looked at in isolation, this competition seems good for consumers, since everybody must cut prices. But when you step back and look more carefully, say structural-reform advocates, far from promoting “market competition” in Japan, the corporate zombies are perpetuating the deflationary spiral. Take over the banks and let these companies go bust, say the reformers, and you will help arrest deflation by eliminating much excess capacity.

It does not matter so much exactly how the government does this. It could nationalise the banks, and use its control to deny credit to hopeless debtors. Or it could single out the most indebted companies and find some way to drive them into receivership, perhaps by simply publishing a list and letting suppliers and lenders do the job. Either way, the effect would be the same. It would also be helpful to cut off the fiscal tap to sectors such as construction, and perhaps channel more public money towards the workers who will be laid off after structural reforms.

Koizumi's conundrum

How has all this affected Mr Koizumi's calls for reform? The basic, abridged, version is that Mr Koizumi, a longstanding LDP insider with a funky hairstyle and a gift for plain talk, persuaded the party's grass roots that he was more eager for change than his rivals in the LDP leadership, and that this was a good thing. The party rank-and-file propelled him to the top last April, after the previous prime minister, Yoshiro Mori, bumbled himself out of the job.

Mr Koizumi started off well, promising to clean up the banks, restrain government borrowing and derail the gravy train through “structural reform without sanctuary”. The wider public adored his brisk style of speaking, and

AP

his promises to inflict pain for the sake of future gain. When teamed up with his combative foreign minister, Makiko Tanaka, who promised to expose corruption and insubordination in her ministry, Mr Koizumi achieved strong public approval, with more than 80% of Japanese voters, at the high points, saying that they backed his government.

But three developments have helped to pull Mr Koizumi to earth. First, he could not reform much since he does not really run Japan. The despised “resistance forces” in the LDP and the bureaucracy have watered down all his plans and slowed their passage, depriving Mr Koizumi of both momentum and results.

Second, these forces, having bought time, have cashed in on the recession by persuading people that Japan needs to pursue “anti-deflation” (by which the LDP means more public spending) before structural reforms (which would cut off the tap). This put pressure on Mr Koizumi to push his own budget, which at least has better priorities than his opponents'.

Koizumi looks into the abyss

But then he botched his response to the third development: Ms Tanaka's battle with the bureaucrats and the LDP old guard. In order to ease the passage of his budget, Mr Koizumi sacrificed Ms Tanaka, foolishly provoking a backlash and losing his only real asset, his popularity.

What happens now? Many of Mr Koizumi's reforms seem less likely than ever to happen. If asset prices continue to slide, the government may have to deal more actively with the banks' bad debts. More likely, it will keep muddling through, announcing just a few measures to prop up the banks, without solving their underlying problems. A mildly lower yen might, in the meantime, mildly boost exports; and Japan may get a boost in May and June when it co-hosts soccer's World Cup. Alas for Mr Koizumi, and for Japan, the real crisis that would force an acceptance of reforms could still take longer to arrive.

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Climate change

Blowing smoke

Feb 14th 2002
From The Economist print edition

Nearly a year after trashing the UN's Kyoto Protocol, George Bush has finally come up with his domestic policy on global warming. Is it any good?

AMERICA is committed “to a path to slow, stop and then, as the science justifies, reverse greenhouse gas emissions growth.” George Bush was due to utter those grand words on February 14th, just as this newspaper went to press. They sum up his long-awaited policy on global warming.

The strategy commits America to “an aggressive strategy to cut greenhouse gas intensity by 18% over the next ten years”. It talks of a robust registry of emissions that would give businesses incentives to invest in new, cleaner technology and voluntarily reduce greenhouse gas emissions. In 2012, progress will be reviewed and “additional action” taken if necessary.

At first blush, these elements seem to add up to a serious policy on climate change. But why should Mr Bush offer a plan at all? Many of his natural supporters are convinced either that global warming is scientific rubbish, or that any effort to mitigate it would prove an economic nightmare. And the president's clumsy handling of climate policy has got him into trouble for most of the past year. Last March, he announced that he had changed his mind about a campaign pledge to regulate carbon dioxide, the principal greenhouse gas (GHG) thought to be behind global warming. Soon after, he confirmed that he thought the Kyoto Protocol “fatally flawed”. Political leaders in Europe and greens everywhere—already furious with America for being the largest contributor to man-made GHG emissions—immediately branded him the “Toxic Texan”.

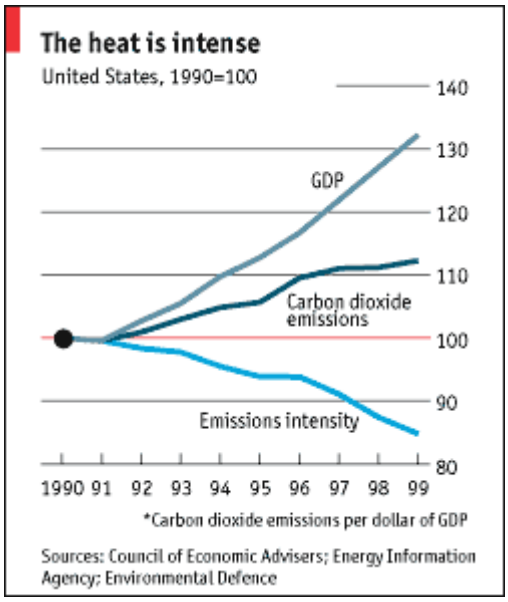
It is amazing, then, that Mr Bush has dared once more to stick his neck out on the subject. Perhaps his objection to Kyoto really was high-minded, as he claimed. Perhaps, too, he really meant what he said when he insisted last June that climate change was a serious problem that deserved a serious policy response.

Yet as this week's Economics Focus explains (see article), any credible policy on tackling climate change must include either a carbon tax or a mandatory target for limiting carbon emissions. The former could be implemented all through the economy with little red tape. The latter would be more unwieldy, but would probably include a mechanism for trading carbon permits among companies (a “cap-and-trade” scheme) that would greatly reduce the cost of cutting emissions.

Mr Bush's proposal contains neither of these. Of course, a tax would be unpopular. However, a flexible cap-and-trade proposal might not be. The environmental chapter of the new report prepared by Mr Bush's own Council of Economic Advisers is full of praise for market-based policies. Various proposals of

this sort are already floating around Congress, and a number of big corporations, including coal-fired utilities, have publicly asked the government for such an approach.

So what exactly does Mr Bush's policy contain of substance? The 18% target for reductions over the next decade sounds impressive. But Mr Bush is not talking about reducing emissions of GHGs, only emissions intensity—that is, the level of emissions per unit of economic output. That is utterly inadequate as a target, as the 1990s showed (see chart), since it is a virtual guarantee of much higher absolute levels of GHG emissions in a decade.



The notion of improving America's registry for GHG emissions is certainly a good one. Done properly, it would help firms take stock of their actual emissions, and could set the foundation for a sensible scheme for trading emissions credits. What is more, existing registry schemes like America's Toxics Release Inventory, which forces companies to disclose details of their use of chemicals, achieve environmental goals not through red tape but through the “power of sunshine”: the fear of appearing at the top of the list of polluters encourages firms to clean up their act. But for any reporting system to be meaningful, it must be mandatory—and Mr Bush is too timid to suggest that.

The president raises the possibility of an effective trading scheme only in the distant future, long after he has left office. If his voluntary measures do not help the economy to meet his voluntary emissions target (however that is measured), he promises much tougher action in 2012: possibly a market-based programme, extra incentives and more—wait for it—“voluntary measures”.

What a sham. As Eileen Claussen of the Pew Centre says, “This is just an effort to cloak ‘business as usual' in some finery. Emissions will continue to grow.” Mr Bush was right to reject the prohibitively expensive Kyoto pact, but he promised a substantial and cost-effective domestic policy to take its place. This is not it. As the president himself might say, his proposal is all hat and no cattle.

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The defence budget

Transformation postponed

Feb 14th 2002
From The Economist print edition

The war in Afghanistan revealed what weapons America needs. George Bush's new defence budget largely ignores its lessons

Reuters

Is this really necessary?

IT USED to be a commonplace among conservative opponents of Bill Clinton that his defence policy, like the account he gave of his personal behaviour, was dishonest. On the one hand, the Clinton administration remained committed, at least in theory, to a dozen or so ambitious new multi-billion-dollar weapons-building programmes, without ever quite explaining where it was going to find the money. On the other, it allowed procurement spending to languish, and so saw its ships, aircraft and tanks grow gradually older.

Another school of critics attacked Mr Clinton's policy from a different angle. In cold-war times, they said, the communist challenge imposed a certain discipline on defence-spending choices. If a contractor failed to produce the right things to counter the Soviet threat, the Pentagon would remove its custom. In the 1990s, with no specific threat to guide policy choices, defence-industry lobbyists ran amok, both in the Pentagon and on Capitol Hill.

Now that President Bush has announced a $48 billion increase in defence spending for 2003—the biggest annual increase for 20 years—the Pentagon can, at last, claim to be putting its money where its mouth is. Money will be available for building almost all the new weapons dreamed up over the past decade. The Defence Department will press on with the production of three new kinds of tactical fighter aircraft—the Joint Strike Fighter, the F-22 and the (already well advanced)F/A-18—for a total cost of more than $300 billion. Even more controversially, it will proceed with the Crusader, a self-propelled howitzer whose value has often been questioned by radical defence thinkers. Malicious souls cannot help noticing that the Crusader's manufacturer, United Defense, is part-owned by the Carlyle Group, in which some top Republicans, including George Bush senior, are involved.

At a time when the existence of a deadly threat to the United States is not in question, and the increase in total spending is by any standards generous, criticism of the defence budget may appear carping or even unpatriotic. But for backers of a rapid change in America's defence policy—putting greater emphasis on state-of-the-art electronics and less on heavy armour and manpower-intensive weapons—the first defence budget bearing the Bush administration's stamp is a let-down. “They are proposing to spend 12 times more on tactical aircraft than on unmanned ones,” says budget-watcher Steve Kosiak, who called the 2003 plan “rather disappointing” for reformers.

The war in Afghanistan, as critics point out, added weight to their argument that America needs greater ability to project power with deadly accuracy over enormous distances: in other words, more long-range bombers and cruise missiles. Tactical fighter aircraft, which require access to bases on the soil of possibly fickle allies, are likely to be of diminishing importance—so why spend $300 billion on producing three new kinds? The Pentagon's choices seem at odds with the pledge by Mr Bush, as presidential candidate, to skip a whole generation of weapons.

Before September 11th, almost everybody agreed that the Pentagon had some hard nettle-grasping to do. Either it had to cut the armed forces, by eliminating some army divisions or aircraft carriers, or it had to cancel some arms programmes; and, at the minimum, it would have to close some surplus military bases. Now it looks as if the imperative for these hard choices has been taken away.

For supporters of “transformation”, the budget did contain some nuggets of good news. They were pleased by the decision to spend an extra $800m on unmanned aerial vehicles, which proved highly effective in Afghanistan at delivering firepower as well as spotting what was going on below. Nor can anyone object to the $900m earmarked for more Joint Direct Attack Munitions, a cost-effective form of “smart” or satellite-guided ordnance. And, to those who say the Pentagon is incapable of defeating entrenched lobbies, the administration can point to the axing of a sea-based anti-missile programme that was failing to produce the desired results.

But perhaps the biggest consequences of the newly-unveiled budget are yet to come. As well as adding $9 billion to the procurement fund, the 2003 plan sets aside an extra $7 billion for research and development. This vast scientific effort seems certain to widen the gap between American and European military technology to the point where it cannot be closed.

After years of scolding European governments for their failure to spend enough on defence, there is now a new toughness in the Pentagon's message to its NATO allies. Richard Perle, the chairman of the Defence Policy Board, which advises the Pentagon, says Europe's armed forces have already “atrophied to the point of virtual irrelevance”. According to Vago Muradian, a Washington-based observer of the arms industry, America's defence chiefs are all but resigned to the reality that—barring a few pockets of excellence, such as special forces—“Europe's military capability is bankrupt.” And they have given up wasting their breath, and energy, on galvanising feckless European friends. They have a war to fight, and fretting over incompetent allies is too much of a distraction.

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Faith-based institutions

Compassionate conservatism?

Feb 14th 2002 | WASHINGTON, DC
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Sorry—make that "the armies of compassion initiative"

GEORGE BUSH is nothing if not dogged. Witness his latest effort to help so-called "faith-based organisations" carry out social-welfare programmes with taxpayers' money. This was a signature issue of his presidential campaign, along with tax cuts, education reform and a missile-defence shield. Those other top priorities passed into law and policy long ago. But the faith-based legislation—rare evidence that compassionate conservatism is more than just a slogan—has languished.

Last July, for example, the House of Representatives passed a version of the law with almost no Democratic support. This seemed to doom the legislation to a lingering death in the Democrat-controlled Senate. More than a year into Mr Bush's term, his main achievement was to replace one awful name with another: the "faith-based initiative" has become the "armies of compassion initiative".

The outburst of volunteerism after last year's terrorist attacks has enabled him to rescue the programme. Late last week, the legislation re-emerged in the Senate, stripped of some of the constitutionally suspect provisions that had persuaded House Democrats to vote against it, and bundled up with wider proposals to encourage national service.

The Senate proposal by Joseph Lieberman, a Democrat, and Rick Santorum, a Republican, would give donors to religious charities new tax breaks, allowing those who do not itemise their returns (ie, most lower- and middle-income taxpayers) to get a tax deduction of up to $800. The bill would also give state governments more money to pass on to social-service providers. Mr Bush says he will support this bill, rather than the House one, improving the chance that it will become law.

Critics claim that the bill would nevertheless violate the constitutional separation of church and state by allowing public money to be spent on what are essentially religious services. The charge looks dubious. As the former head of the faith-based office, John DiIulio, says, the bill forbids "any use of public funds for worship, religious instruction or proselytising". It also denies churches exemption from federal laws which forbid discrimination against homosexuals—a controversial part of the House bill. But churches will not have to take crucifixes and other religious symbols off the walls and will remain able to favour members of their own faith in hiring, even for social programmes paid for with federal money.

The president has long argued that religious charities are better than state bureaucracies at helping the poor, because they are better at changing self-destructive behaviour. There is anecdotal evidence for this, but no one knows if it can be replicated nationwide. The idea also faces two more immediate doubts.

First, money. Supporters say there is lots of pent-up demand for social work by religious charities. The Senate reckons the tax breaks will be worth around $10 billion in the next two years. But the first impact of September 11th on charitable giving has been to reduce contributions to the big religious charities, so that estimate may be optimistic.

Second, churches, mosques and synagogues may not fit easily into the president's broader agenda of encouraging national voluntary service. Their comparative advantage lies in mobilising local congregations (see article). But Mr Bush has linked his "armies of compassion" effort to a new national voluntary-service initiative called the USA Freedom Corps. Co-ordinating local and national policies will be hard.

Still, compassionate conservatism is back after a false start. And the test of whether it works is about to begin.

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Mormon welfare schemes

Bishop's move

Feb 14th 2002 | SALT LAKE CITY
From The Economist print edition

A great way to organise charity, but very hard to copy

IF YOU want to know why George Bush thinks religious charities are good at welfare services, go to Salt Lake City. But you will also discover a big problem with the president's "armies of compassion" plan: successful churches don't need help.

The welfare system in question is run by the Church of Jesus Christ of Latter-Day Saints, better known as the Mormons. It is one of the most intensive such programmes in the world, and it comes in two parts.

First, the "fast-offering". Mormons are supposed to forgo two meals a month and donate the cost of the food to a local fund for the needy. This may not sound much but it gives each (relatively small) congregation over $50,000 to spend a year, which buys a lot of soup kitchens. With 3,600 congregations in Utah alone, the system produces nearly $200m annually: about a fifth of what Utah's state government spends on welfare, and almost as much as it spends on health.

The really striking feature of the system, though, is the way it is run. All the money stays with the congregation and the volunteer layman who heads it (confusingly called a bishop, the lowest rung in the Mormon's lay clergy). "When I was a bishop," says Bob Bennett, now a senator, "I could write out a cheque for $500 and just hand it over to someone I thought needed it."

Obviously, this could not work in a government department using taxpayers' money. It works among Mormons only because congregations are small (everyone knows one another) and, as Mr Bennett says "everyone trusts the bishop." But there are, he claims, two big advantages. There is no bureaucracy, so help can be custom-made. One bishop was asked for help by a parishioner who had found a job but could not get to it: he bought her a second-hand car. And there is no sense of entitlement, so no welfare-dependency.

Second, Mormons have a formal welfare system for providing food and jobs. The church runs a number of farms, canneries and other commercial companies. It can simply allocate jobs (temporary ones) for those out of work. One of these firms is a chain of supermarkets. The hungry and penniless have merely to go to the bishop; he will approve a shopping list, and the grocery will provide the goods free.

The Mormon welfare system shows how comprehensive church-run social services can be. Unfortunately, it does not support Mr Bush's belief that federal tax breaks will unleash a wave of such projects. When the president announced his programme, the church authorities were polite, wished him well—and said they wanted nothing to do with it. The system runs because Mormons give up time and money. Tax breaks will make no difference to that—but they may, the church fears, enmesh the welfare system in a tangle of government restrictions.

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About sponsorship

Trade policy

Romancing Big Steel

Feb 14th 2002 | WASHINGTON, DC
From The Economist print edition

George Bush's promises to help are coming back to haunt him

AP

There's votes in those furnaces

THEIRS has been a highly public courtship. Before the 2000 election, Dick Cheney, as George Bush's running-mate, wooed West Virginia's steel workers, promising that his boss (unlike Bill Clinton) would not forget them. In June 2001, Mr Bush made the first move. He called for an investigation into whether American steel needed protection against imports and demanded international action to cut steel capacity. In August, he told cheering steel workers in Pittsburgh that their product was “an important national security issue”. Romancing Big Steel made clear political sense: it would win votes in swing states such as West Virginia and Ohio.

Since then, the plight of the steel industry has worsened. Prices are at a 20-year low; 21 steel mills have filed for bankruptcy since the 2000 election. Mr Bush must decide by March 6th what kind of trade protection he wants to give. The big steel firms are calling for a minimum 40% tariff on most products. They also want government help in paying for so-called legacy costs—the health and pension benefits promised to retired steel workers. These legacy costs, for about 600,000 retirees, reach a whopping $13 billion.

But as the March 6th deadline draws closer, the Bush administration may be getting cold feet. Steel is no longer simply a domestic vote-winner. From Korea to Kazakhstan, a steady stream of foreigners has complained about the prospect of high American tariffs on steel. The European Union will be furious, particularly since most surplus global steel would be diverted to Europe. A full-blown trade war cannot be ruled out. The EU-US partnership to push the new Doha round of trade talks would be severely undermined. Brazil, too, is up in arms. Steel tariffs would also anger other allies in the war against terrorism, notably Russia.

At the same time, domestic voices are piping up. After all, 12m people work in steel-consuming jobs, while only 160,000 people produce the stuff. This silent majority seems at last to be stirring. One study, sponsored by a group of steel consumers, suggests that 20% tariffs would save fewer than 9,000 steel jobs, but would cause over 74,000 lost jobs elsewhere. In other words, eight jobs would be lost for every steel job saved.

Ever more employers are lobbying against steel tariffs. Caterpillar, a heavy-machinery producer, has long railed against steel protectionism. It has been joined by a roster of others, from machine-tool firms to the Port of New Orleans. Some giants, notably car firms, are relatively silent, worried more about keeping their unions happy than keeping steel prices low. But a few brave politicians, such as Senator Chuck Hagel of Nebraska, are speaking out against steel tariffs.

Within the administration itself, some voices oppose a Big-Steel bail-out. The economists worry that tariffs will hamper the recovery, and many are (rightly) reluctant to see the government take on legacy costs. Bailing out steel firms would set a terrible precedent. It would also be politically difficult just now. (What about Enron's retirees?) Some suggest a more modest package: generous quotas with tariffs for imports above them and some general federal assistance for displaced workers.

The uncertainty lies in the political calculations. Some Republican seats in the House of Representatives may be at risk if Mr Bush angers the steel lobby. So may fast-track legislation. Fast-track, the authority the administration needs to negotiate trade agreements, passed the House by one vote in December. It

will almost certainly need to pass the House again after being reconciled with a (yet to be passed) Senate version. Without the votes of Republicans from steel areas, that could be hard. Mr Bush's wild approval ratings suggest he could dare to jilt Big Steel. Less obvious is whether he has the will.

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About sponsorship

Indian business

Chips with everything

Feb 14th 2002 | LOS ANGELES AND SAN DIEGO
From The Economist print edition

Are their new casinos in California good for the tribes?

HIGHLAND, where the freeway running east from Los Angeles tips you into a grid of burger bars and mini-malls, seems just another block of America's most celebrated stretch of sameness. Drive to the sharp rise at the end of the road, however, and things change abruptly.

Five flat acres at the foot of the San Bernardino mountains and 700 vertiginous ones behind them make up the reservation of the San Manuel band of Indians. The 180 members of the tribe are a sovereign nation, and within their narrow boundaries they run their own affairs. These include a casino that employs 1,500 people. The San Manuel casino may not boast neon and fountains on the scale of the Las Vegas Strip, but most of the games are there, plus cabaret acts.

A similar story is unfolding at Temecula, towards San Diego. Anthony Miranda, president of business development for the Pechanga tribe, looks out from his office at the frame of a 550-room hotel rising rapidly alongside a casino in which slot machines are already chiming. A golf course is promised soon.

These things are possible because Indians are no longer bound by California's constitutional restrictions on gambling. Until March 2000 the tribes offered only bingo parlours; the law held them back from more lucrative games such as blackjack and from installing slot machines, the fast-food franchises of gambling. Then California's voters passed Proposition 1A, allowing the tribes to open proper casinos.

So far, 45 tribal casinos are up and running; 17 other tribes have done the paperwork. This makes Las Vegas nervous. California has a lot of tribes—108 of the 561 recognised by the American government. And it sits right next-door. A third of the 36m visitors to Las Vegas in 2000 and half of the 5.2m who went to Reno, Nevada's other big gambling spot, came from California, most by road.

The Las Vegas casinos have spent $20m fighting Indian gambling, though they abandoned the fight against Proposition 1A well before it came to the vote in the face of massive popular support in California. Now Nevada officials complain that the Californian casinos are taking 10% of their business ($1 billion a year). The Indians, though they offer no figures of their own, dismiss that as a wild exaggeration.

So far, interest in starting casinos has largely been confined to the 40 tribes that already had bingo parlours. But the casinos which have opened pose their own problems, particularly for their suburban neighbours. People who live around the Barona reservation close to San Diego complain that the tribe is drawing too much underground water from the local aquifer to feed a new golf course. San Diego County officials claim that improving the roads to cope with traffic to Barona and four other dramatically expanded former bingo parlours will cost $500m. Brand-new casinos are even less popular.

More fights may lie ahead. Some 50 unofficial tribes in California are demanding recognition by the government, and with it the right to reservations of their own. Some tribes impatient with the slow process of federal recognition have gone directly to Congress. The Lytton band of Pomos, who are landless, persuaded George Miller, a Democrat from Martinez, to add an amendment to a bill allowing them to acquire and convert into a casino a run-down card room on the main road from San Francisco to Reno. The plan was foiled, predictably enough, by a senator from Nevada, Harry Reid.

Opponents of Indian gambling have themselves been devising new strategies. One group is working to put a proposition on a future ballot in California that would require the closure of all but one Indian casino and instead allow 12 cities, chosen so that 80% of the state's population is within 50 miles of one of them, to open casinos run for the local governments' profit. It seems unlikely to pass.

Are the casinos good for the Indians? In other parts of the country, some people have argued that casinos have proved a curse in disguise for the tribes, encouraging a cycle of dependence, with much of the money frittered away. The Californian Indians—so far at least—beg to differ. They point out that both the hoopla about Proposition 1A and the new visitors to the casinos have given public recognition to a culture that seemed to be disappearing. Casino money has gone into improving housing, roads and so on, and paying for scholarships for the young and medical treatment for the old. Mr Miranda boasts that none of the 850 voting members of the Pechanga any longer receives government welfare payments.

Back in Highland, Deron Marquez, chairman of the San Manuel, wants a broader economic base than just the casino. His tribe is building a new hotel and shopping complex, linked to the casino, and turning some buildings on the former Norton Air Force Base into factory space. On the reservation itself the tribe has built a bottling plant, and this month starts selling the water that rises in its 20 springs. Coca-Cola and other giant firms in the bottled-water business will be tough competition. “But so was Las Vegas,” chuckles a member of the tribal council.

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Campaign-finance reform

Soft money, tough measures

Feb 14th 2002 | WASHINGTON, DC
From The Economist print edition

So it's back to hard money, then

Get article background

“THE moment of truth has come,” said Marty Meehan. After years of false starts, Mr Meehan, one of two sponsors in the House of Representatives of an endlessly debated bill to reform America's campaign-finance laws, was right at last. By passing a bill to limit so-called “soft money” (unregulated contributions to political parties), the House has paved the way for the biggest change in the financing of America's elections since 1974.

The vote was touch and go. Late into the night of February 13th, the reformers were battling to save their self-denying ordinance from the “poison pills” of their opponents. These pills included a tougher version of reform, introduced, bizarrely, by those who think soft money is a good thing, and a measure that would have allowed parties to use soft money raised until January 2003 to pay off current debts—something the White House opposed.

The aim of such pills was to get a bill through the House different from the McCain-Feingold version accepted by the Senate last year, forcing the two chambers into a conference to reconcile their bills—a process that would have given opponents one last chance to strangle reform. In the event, Mr Meehan and his co-sponsor, Christopher Shays, marshalled enough votes to defeat each poison pill. Their hope now is that the Senate will pass the House version of the bill, by-passing a conference and dispatching the bill to the president.

What made the difference this time was the Enron affair, and the sense it engendered that interest groups are buying political influence. It is certainly true that in the past few years, soft money—that is, money from companies, unions and advocacy groups—has been the fastest-growing part of the campaign system. In the 2000 election, the parties broke all known records by spending $500m of soft money. And in 2001 they raised 50% more than in 1999, the previous non-election year.

So, like McCain-Feingold, the Shays-Meehan bill proposes to ban national party committees from receiving soft money from companies, unions and advocacy groups, though it would allow parties at state level to get up to $10,000 from such groups for get-out-the-vote and registration drives. It would also prevent organisations from using soft money to buy “issue ads” (advertisements pretending to be about an issue but actually attacking a candidate) 60 days before an election and 30 days before a primary—an action, opponents say, which restricts free speech.

The notion here is that “soft-money” is a kind of arms race in which companies and others give contributions not to buy influence but out of fear that rivals will steal a march on them. The curious fact, though, is that many of Enron's contributions came in the form of “hard money” (direct contributions to candidates, not parties). And Shays-Meehan actually increases the size of some of these. If the measure becomes law, individuals will be able to give $2,000 to congressmen, $2,000 to senators and $30,000 to parties.

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Lexington

The businessman as villain

Feb 14th 2002
From The Economist print edition

America's love-hate relationship with the corporate world

ONLY the other day Kenneth Lay was heralded as a business genius. Now he is dismissed as a villain. This week, Enron's former boss further burnished his reputation for villainy, first by refusing to appear before two congressional committees and then, when faced with a couple of subpoenas, turning up and—like any Hollywood villain in such circumstances—exercising his Fifth Amendment right to remain silent.

Does Mr Lay's fall from grace presage a wider change in attitudes to business? Many think so. Ralph Nader, a veteran anti-corporate crusader, points out that the Enron affair has all the right ingredients for galvanising opinion: identifiable villains such as the shifty Mr Lay and the unbearably arrogant Jeffrey Skilling; poor working stiffs who have been bilked of their pensions; and plenty of collusion and corruption in high places.

Paul Krugman (an economist-turned-columnist who was once on Enron's payroll) argues that the Enron scandal will prove a greater turning-point for America than September 11th. George Will, hardly a leftist, talks in his columns of a “systemic crisis of capitalism”. The Enron affair comes at a time when anti-globalisation protesters have been flexing their muscles, and when popular enthusiasm for government is unusually high.

There is even a striking historical parallel between Mr Lay and an earlier business villain who helped to provoke the regulatory surge of the 1930s. Samuel Insull turned a modest energy company called Middle West Utilities into the hub of a vast financial empire made up of interconnected companies with interlocking boards. His empire collapsed amid accusations of stock fraud and crooked accounting; congressional hearings followed, together with ringing promises that such a thing would never be allowed to happen again.

But is America really preparing for a backlash against business (whatever that may mean)? And are Americans really so simple-minded that they shift swiftly from unbridled enthusiasm to unbridled scepticism? A glance at the past two decades suggests that the picture is rather more nuanced.

At first blush, the 1980s and 1990s, with the stockmarket roaring away, appear to have been a time of uncritical admiration for business. Inane business books leapt to the top of bestseller lists. Jack Welch graced almost as many magazine covers (including *The Economist*'s) as Madonna. Bill Gates attracted far more attention at economic gabfests than a mere head of state.

On closer inspection, however, anti-corporate feeling was rife. Michael Milken and a clutch of other financial wizards ended up in jail. The upsizing of bosses' pay and the downsizing of the workforce made many people angry. With “Wall Street” and “Barbarians at the Gate”, Hollywood turned business-bashing into an art form. *Newsweek* splashed “corporate killers” on its cover. Pat Buchanan's peculiar brand of anti-corporate Republicanism roiled his then-party's primaries in both 1992 and 1996. In 2000 Al Gore won the popular vote with a campaign that championed the people against corporate interests.

Malefactors of wealth

Richard Tedlow, a historian at the Harvard Business School, points out that Americans have always been ambivalent about business. It is not that they alternate between periods of loving business and periods of hating it; they love it and hate it at the same time. These contradictory feelings focus on two things.

The first is equality. America is dedicated to the principle that all men are created equal, but businesses are by nature hierarchical. Bosses are paid hundreds of times more than shop-floor workers. Senior managers glory in bigger offices and better perks. People accept this so long as it reflects merit. But as soon as they get a whiff of unfairness, they turn violently against it.

The second concern is sheer bigness. Americans have always worried that gargantuan businesses will limit consumer choice and force small firms into bankruptcy (see the vilification of Mr Gates over Microsoft). In his pamphlet “The Curse of Bigness”, Louis Brandeis, a Supreme Court justice, said “businesses may keep growing bigger but human beings come in the same size.” The sheer size of big business, some Americans fear, may unbalance a constitution based on checks and balances.

This ambivalence means that even pro-business opinion has an undercurrent of scepticism. Some of the sharpest critics of business are Republicans. It was Theodore Roosevelt who coined the phrase “malefactors of great wealth” and Dwight Eisenhower who fulminated against “the military-industrial complex”. Today's most impressive scourge of corporate shenanigans is another Republican, John McCain.

But this ambivalence also means that anti-business sentiment is kept in check. Consider the late 19th and early 20th centuries. Rockefeller's way of dealing with competition was to buy it or bury it. J.P. Morgan's US Steel Corporation was so big that its market capitalisation was equivalent to two-thirds of all the money then in circulation in the country. America's response? Not European-style socialism, but the antitrust movement.

Or consider the Great Depression. Between 1929 and 1932 the American economy shrank by 26.8%, while unemployment leapt from 3% to 24%. FDR was a master of stirring up hatred of the “economic royalists” who were ruining the country. But there was so little support for socialism that, even in the depths of the depression in 1932, a socialist presidential candidate won a mere 2% of the vote.

The Enron affair, though it raises many questions, is not arousing fury because Americans are turning against business; it is doing so because so many Americans have put money into the stockmarket. A businesslike people cannot afford to see lax rules and unscrupulous chancers undermine the health of the entire system. America loathes Mr Lay because it treasures the notion that business should do the country good.

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Drugs in the Andes

Spectres stir in Peru

Feb 14th 2002 | LIMA
From The Economist print edition

Partly because of Plan Colombia, Peru's illegal drug industry is reviving. Meanwhile, Bolivians are protesting against drug eradication (next article)

Get article background

THE harder you squeeze the illegal drug industry in one part of the Andean region, the more it balloons out elsewhere. That has been the experience over the past quarter-century of the United States' "war" against the production of cocaine and, more recently, opium poppies in the Andes. Over the past year, with much American help and money, Colombia's government has stepped up the eradication of drug crops. So it is not surprising that there are now clear signs of an increase in the production of coca (the shrub from which cocaine is extracted) and poppies (the source of heroin) in Peru.

These trends are worrying ones for the anti-drug warriors. On March 23rd George Bush is to make a flying visit to Peru, partly to show support for newly-restored democracy, but mainly to talk about fighting drugs and terrorism, and boosting trade, with President Alejandro Toledo and the leaders of other Andean countries.

This visit comes as the tide in Peru is turning in favour of the drug traffickers once again. The country was the world's largest coca producer until the mid-1990s, when production shifted to Colombia. This week, the United States' government said that according to its estimates, Peru's coca crop last year covered 34,000 hectares (84,000 acres), a similar figure to that for 2000 despite the eradication of 6,000 hectares. But American officials admit that their tracking system (derived from satellite imagery and sample field checks) is poor at detecting young plants. By contrast, Ricardo Vega Llona, Peru's "drug tsar", reckons there are at least 50,000 hectares of coca; the UN's preliminary estimate is only slightly less (it put the figure at 44,000 hectares in 2000).

As troubling as the figures is the fact that there are plenty of economic incentives for Peru's coca

industry. The farm-gate price for coca leaves has risen to an all-time high of around $3.50 per kilo, against 40 cents at the low point in 1995. Coca is competitive against other crops at $1 per kilo. On the other hand, the price of coffee, the most obvious coca substitute for farmers on the tropical Andean slopes, has slumped to below the cost of production.

The rise in the coca price may partly reflect an easing of repression. A policy of shooting down suspicious planes in eastern Peru was halted last year, after an American missionary and her baby were killed. (Peru wants to restart this air interdiction, which relies on American spy planes; American officials say they hope to announce a resumption during Mr Bush's visit). The fall of President Alberto Fujimori's authoritarian regime in 2000 revealed a web of corruption, including claims that Vladimiro Montesinos, his security adviser, took drug bribes. Since Mr Toledo took office last July, he has been busy trying to rebuild democracy and the economy, though Mr Vega Llona says traffickers are still being harried.

Gangs based in Peru are starting to produce more cocaine themselves, rather than exporting semi-processed paste to Colombia. But Colombians seem to be behind the introduction of the opium poppy; unlike coca, it is not indigenous to Peru. Estimates of the crop are sketchy. But 135 hectares were eradicated last year (up from 26 in 2000). Poppies are easier to grow, more lucrative, and harder to detect than coca. They grow at higher altitudes, above the operating ceiling of police helicopters.

To complicate matters, there are signs of a guerrilla revival in the drug areas. “Security has loosened slowly but steadily since the last years of the Fujimori regime,” said Patrice Vandenberghe, the UN's anti-drug man in Lima. Under Mr Fujimori, many drug areas were under military rule. But facing budget cuts, and demoralised by allegations of corruption and human-rights abuses, the army has pulled back, closing bases in these areas (though the police are still present).

Officials deny reports that Colombia's FARC guerrillas have infiltrated Peru, at least beyond the border area. But the tiny rump of Peru's Shining Path guerrillas, a big force a decade ago but now numbering perhaps 300 (not all armed), is expanding into a vacuum left by the army. Field workers have reported Shining Path incursions in the Monzon and Apurimac valleys: guerrillas have lectured villagers, given them provisions and pressganged youths. Without law and order, coca will thrive, but normal economic activity will not.

The government is now taking steps to improve security. Fernando Rospigliosi, the interior minister, says he is asking the army to restore some of its bases (though not military rule). He is appointing new civilian “peace commissioners” to co-ordinate anti-terrorism efforts with civic bodies. And he plans to double the number of drug police based east of the Andes.

But the government may find it hard to meet its target of eradicating 7,000 hectares of coca this year, without stirring violence. There are no police in the Monzon valley, for example; they could enter only “with blood and gunfire”, says Mr Rospigliosi. Drug policy “can't be just repression, there has to be a proposal in it for the people too,” he says. Mr Vega Llona is working on an overall plan, including alternative crops such as palm heart or cotton, and the infrastructure needed to make them viable. Just rebuilding Peru's jungle trunk roads would cost around $1 billion.

American officials have acknowledged that Plan Colombia will affect the neighbours. The United States' Congress has tripled anti-drug aid for Peru this year, to $156m, including $30m to upgrade police helicopters for opium areas, and more than $80m for alternative development. Peruvian officials stress that the drugs trade is bad for democracy, security, the environment and health. “Drugs trafficking is not going to disappear as long as there are users,” says Mr Vega Llona. “But we're going to squeeze it.” Maybe so, but as always, this looks like an unequal fight.

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Drugs in Bolivia

Leaves of discord

Feb 14th 2002 | LA PAZ
From The Economist print edition

A hardline on coca meets bloodshed

Get article background

ON TAKING office as Bolivia's interim president last August, Jorge Quiroga said he wanted the world to know his country for its gas rather than for drugs. But while a plan for exporting natural gas is moving ahead, coca refuses to die. Angry would-be coca farmers have repeatedly blockaded roads and towns.

Under the “Dignity Plan” begun by Hugo Banzer, who stepped down as president last year because of illness, Bolivia has cut illegal coca production from 38,000 hectares in 1997, to just 6,000 hectares last year. Another 12,000 hectares is legally grown for traditional uses, such as chewing and tea. In November, Mr Quiroga, who was Mr Banzer's vice-president, issued a decree to limit the drying, transport and sale of coca at hitherto legal markets, brushing off protests that this was unconstitutional.

But an attempt to implement the decree last month set the country alight. The government tried to close the coca market in Sacaba, a town near Cochabamba, Bolivia's third city and the heart of the coca-growers movement. Police were met by an angry mob. Three days of clashes left seven dead (four of them policemen) and 50 injured. In what looked like a reprisal, a new congressional ethics commission ordered that Evo Morales, the coca growers' leader, be expelled from his parliamentary seat. That triggered more marches, and the death of three more protesters.

On February 9th, peace was patched together. Mr Morales called off most of the protests in return for a government promise to amend the decree. But neither Mr Quiroga, nor the main candidates in June's presidential election, will want to risk American wrath by beating an undignified retreat from the policy of zero tolerance for coca. On the other hand, in impoverished Bolivia, coca remains an economic magnet. More clashes seem inevitable.

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Venezuela's economy

Lenten diet

Feb 14th 2002 | CARACAS
From The Economist print edition

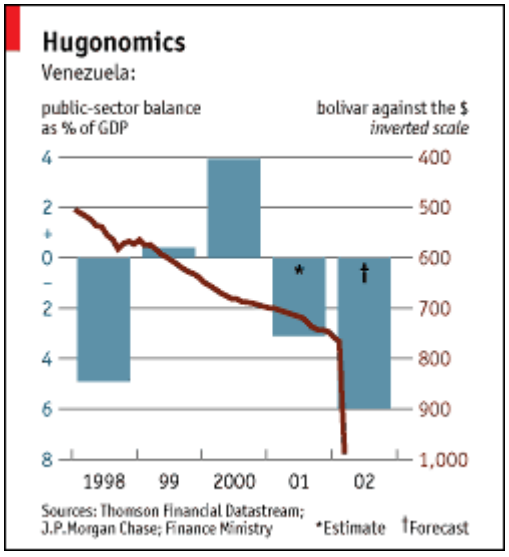
Devalued currency, humbled president

NOT only does Hugo Chavez, Venezuela's rumbustious president, face a sharply polarised country, and an opposition out to unseat him. He must also grapple with a sagging economy. After $700m fled the country last week, many economists believed that Mr Chavez would use the carnival holiday to decree exchange controls to defend the overvalued currency. Instead, on February 12th, the rarely predictable president announced that the bolivar, like the Argentine peso, would now float freely, and that the government would try to get its finances under control. The currency promptly plunged by 19% against the dollar.

Mr Chavez blamed world recession and Argentina's troubles for these moves. Certainly, cheaper oil always clobbers Venezuela's economy, and its government's revenues. But the president scarcely mentioned the other main cause of the economy's troubles: continuing political turmoil, which has provoked capital flight. Last week saw public calls by two serving military officers for his own resignation, backed by a spontaneous demonstration by thousands of citizens.

Nevertheless, with rare humility, Mr Chavez said he was willing “to rectify whatever needs rectifying”. He announced budget cuts, though also a raid on the “stabilisation fund”, where a portion of oil revenues are parked for a rainy day. Business leaders and many economists welcomed the belated recognition of fiscal reality, and the decision not to impose further controls. But will the government cut enough to control a ballooning deficit (see chart)? The numbers are still vague. Even at $16 rather than $18.5 per barrel, the government's estimate of the year's average price for Venezuela's oil may be optimistic. So does that for GDP growth, at 3%.

Credit, too, is tight. Despite an increase in the Central Bank's benchmark interest rate (from 40% to 50%), the government is to cut its planned borrowing by half. And foreign investors had started to worry about political instability, though the price of Venezuela's bonds surged this week after Mr Chavez's speech.



Venezuela looks headed for stagflation. Some economists now expect no growth this year. And without the straight-jacket of the exchange-rate band, under which the bolivar depreciated gradually, inflation will surge past the target of 10%. The fall in inflation had been the government's chief economic success. Rising prices and no growth spell bad news for the poor, who make up most of Mr Chavez's dwindling supporters.

Jorge Giordani, the planning minister and hitherto a defender of the pegged exchange rate, said that prices will now be held in check by fiscal restraint. But politics may militate against prudence. Mr Chavez is now reaping his own whirlwind. His aggressive rhetoric and rule by decree have alienated almost every interest group, from business and the unions to the Catholic church and the media. Six months ago the president's offer of “rectification” would have been welcomed. Today, it may be too late.

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Argentina's crisis

Loaded dice

Feb 14th 2002 | BUENOS AIRES
From The Economist print edition

The peso has not crashed—yet

Reuters

The money they trust

“THOSE who bet on the dollar will lose.” Thus Eduardo Duhalde, Argentina's president, last weekend, as he floated the currency for the first time since 1991. Mr Duhalde could be pleased with the initial outcome. Despite predictions of an immediate collapse, by mid-week the peso stood fairly firm, at around 1.90 to the dollar—though that is 47% less than it was worth before Argentina's fixed exchange rate collapsed last month.

But demand for dollars is artificially restricted. Bank savings are still frozen, although the government this week loosened controls on current accounts, releasing about 3 billion pesos. Banks are not selling dollars, except in rural branches. Police rounded up dozens of street money-changers in Buenos Aires. So the only way for Argentines to buy greenbacks is to brave lengthy queues and identity checks at exchange houses. Meanwhile, importers and businesses with foreign debts are still unable to transfer funds abroad.

With these restrictions, and reserves of $14 billion, the government can choose the exchange rate it likes. The test will come when it loosens the controls. By then, it hopes to have backing from the IMF. Jorge Remes Lenicov, the economy minister, visited Washington on February 12th, to start what are likely to be lengthy talks. Agreement may depend not just on passing an austere budget, but on a commitment to fiscal reforms. Until the currency has stronger foundations, many Argentines might bet against Mr Duhalde rather than the dollar—when they are allowed to.

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Mexico's border region

Opportunity lost

Feb 14th 2002 | CIUDAD JUAREZ
From The Economist print edition

America's problems have exposed deep weaknesses across the frontier

IT SITS in an inhospitable desert a stone's throw from America—freezing in winter, boiling in summer and parched all year round. Until recently, Ciudad Juarez was also the dynamo of Mexico's export economy and a magnet for migrants seeking a better life. Now, battered by America's recession and a post-September 11th clampdown on the border, Juarez has lost about 60,000 factory jobs in the past year. Former assembly-line workers try to scrape by, some as prostitutes or pushers. And the city's streets are awash in cocaine that cannot be sent to the United States.

Mexico's 2,000-mile (3,200 km) northern border is its most dynamic region, brimming with plants assembling everything from televisions to car parts for shipment north. Only a year ago, President Vicente Fox pointed to the huge flow of goods and people back and forth (300m people cross every year) as the start of European Union-style Union of North America. The border success, with Mexican hands making products designed by American brains, would become a model for the rest of the country, he said.

But that model now looks a little frail. For the Americans, security, rather than integration, has become the priority. Faced with two-hour waits at crossing points, even the tourists who once slipped into Mexico for a quick trip to the brothel are staying at home. The recession that started in the region's assembly plants has spread south. With exports falling, the Mexican economy shrank by 1.6% in the third quarter of last year, with the loss of more than 380,000 jobs in the formal sector.

The story of Mexico's border, critics say, is one of lost opportunity. During the second half of the 1990s, as free trade with the United States blossomed, employment in border cities grew at a double-digit clip. The new factories drew workers from agricultural states such as Veracruz, Durango and Chiapas, where drought, failed reforms and cheap (often subsidised) imports from America devastated farms. A factory wage of $65 or so a week was more than could be earned on the farm. Border industry turned Mexico into an export powerhouse which, at the peak in 2000, had a $20 billion trade surplus with the United States.

Yet little of that wealth has ever been seen outside the factory gates. In Juarez, a city of 1.3m people, the only local tax is a property levy of just pennies per square metre. As the city swelled, its outskirts became sprawling slums. Now 175,000 residents have no running water, 140,000 lack sewerage and only half the city's 1,200 miles (1,920 kms) of roads are paved. And little money has gone into training a better workforce. On the city's west side, where 500,000 people live in some of Mexico's most squalid slums, the only two high schools have a drop-out rate of 95%.

Only a year ago, workers were so scarce that plants on the border were competing to offer salary bonuses, day care, in-house doctors and company basketball courts. Now the unemployed line up at 3am for the few jobs on offer, and most go away empty-handed. Wages in Juarez, although still among the highest in the country, have begun to fall.

Pessimists fear that some of the work will not return, even when the American economy recovers. While the average labour cost for assembly plants in Mexico is now around $2 an hour, China's figure is 22 cents. Although plants in Mexico are more sophisticated, the country has failed to develop a network of local suppliers that would make it hard for manufacturers to leave as the Chinese catch up. “In terms of training, technology and transport, we didn't prepare when we had the chance,” says Luis Gutierrez, an

economist at Juarez's Autonomous University.

Local leaders say they must improve the skills of the workforce and make more sophisticated products. They are looking at tourism, too. Appropriately enough, there is talk of a new museum of immigration in Juarez. But Juarez is no Bilbao, a former steel city in Spain whose success in reinventing itself with tourism and high-tech services is seen as a model.

Juarez is internationally famous as the home of Mexico's largest drug cartel. Drug abuse—of heroin as well as cocaine—is spreading quickly from the city's hundreds of gangs into the middle class. Mexico's best hope is that Americans' fear of terrorism means that cities like Juarez, to which managers can commute from the United States, come to seem less risky than distant China. By one estimate, employment in Juarez may grow by as much as 3% this year. But the border's boom may finally be over. A region that had no shortage of problems during the good times must brace itself as things turn bad.

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Systemic corruption

Something rotten in the state of China

Feb 14th 2002 | BEIJING
From The Economist print edition

The heresy that haunts the Communist Party

SCHOLARS in China are beginning to suggest what was once heretical: that the country suffers from “systemic corruption”. Officials talk only of the problem of “a very small number of corrupt officials”. But every case that comes to light further exposes a system that breeds corruption at every level. Chinese leaders pledged five years ago to curb the problem by this autumn's Communist Party Congress. They will have a hard time convincing anyone that they have succeeded.

As the congress approaches, allegations of corruption and abuse of power continue to swirl around members of the party elite. Last month's dismissal of the Bank of Construction's president, Wang Xuebing, who is now under investigation for fraud, not only suggested the existence of corruption at the highest levels of the financial system, but also raised questions about the party's ability and willingness to tackle it. Even members of the ruling Politburo appear to keep dubious company, turn a blind eye to corruption or try to cover up cases that might embarrass them.

Mr Wang fell only because a two-year investigation by American Treasury officials uncovered improper loans made by the Bank of China's New York branch in the 1990s. Mr Wang was in charge of that branch until 1993. He was promoted to be president of the bank later that year. It is widely believed that Chinese officials suspected Mr Wang of wrongdoing as early as 2000 when he was transferred from the Bank of China to the Bank of Construction. But what the party knew, and when it knew it, may never be revealed. In 1995 the party ordered that any matter relating to an ongoing probe into malfeasance by a serving leader (which would include the party-appointed bank chiefs) was a “top secret”. Even statistics concerning official corruption were state secrets.

Mr Wang's case must be discomforting for his one-time patron, China's reform-minded prime minister, Zhu Rongji. Though Mr Zhu has not been accused of any wrongdoing in this case, in Chinese politics the fate of a protégé is often linked to the political fortunes of his mentor. Mr Zhu is expected to step down from the Politburo at this year's congress and as prime minister next year. But like other top leaders heading for retirement, he wants to prolong his influence by securing top jobs for his associates. The case of Mr Wang has come to light at a bad time for Mr Zhu and his allies.

Mr Zhu's arch political rival, Li Peng, the head of parliament and the second highest ranking Politburo member after China's president, Jiang Zemin, is in no position to gloat, though when it comes to denouncing corruption, he has been as tough as any. He once told fellow officials, “No matter who the case touches upon, we must pursue it to the end and deal with it according to the law. There should be absolutely no tolerance.” Mr Li is also expected to relinquish his formal responsibilities at the congress and at next year's parliamentary session, but he too wants to keep his hand in politics beyond these events.

Late last year, an intriguing article appeared in a leading Chinese financial journal, *Securities Weekly*, hinting that members of the Li family might be profiting from their powerful connections. The article suggested that Mr Li's wife, Zhu Lin, and his son, Li Xiaopeng, had control over Huaneng Power International, the country's largest independent power producer. It called the firm “a typical family enterprise”. The younger Li is indeed in charge of Huaneng. But Zhu Lin's role is not acknowledged anywhere publicly. In January she took the unusual step of giving an interview to another Chinese

magazine to deny any involvement in Huaneng's business, or anyone else's. For the wife of a top leader to make a public statement of this kind suggests her husband must have been badly stung. Staff at *SecuritiesWeekly* are said to have been disciplined for carrying such a barbed article.

Equally startling are the public demonstrations that have been occasionally allowed on the streets of Beijing by victims of a $60m investment-fund scam allegedly masterminded by Li Peng's other son, Li Xiaoyong. It is hard to say whether it is the streets of Beijing or the state-run media that are more tightly controlled in China, but it cannot bode well for Mr Li that attacks against him are allowed to see the light of day in both places. Mr Li was already politically embarrassed after one of his deputies, Cheng Kejie, was executed for corruption in 2000, the highest-ranking communist official to suffer such a fate.

So pervasive is corruption in China that it would be hard to find any leader whose associates and family members are beyond suspicion. A Chinese handbook for anti-corruption investigators warns that interrogating a crooked senior official can be tough. “He becomes mentally unbalanced. He thinks the organisation is being unfair to him, and that he is being targeted just to cover up for a failure to investigate someone else's corruption properly,” it says. But the suspect may well be right.

China's handling of a huge corruption scandal in the port city of Xiamen demonstrated the limitations of the leadership's resolve. In the past two years, dozens of officials have been jailed or sentenced to death for their role in a multi-billion dollar smuggling ring, including a deputy minister of public security, Li Jizhou, who was given a death sentence in October, suspended for two years, when it will be reviewed. But officials seemed to lose their nerve when it came to dealing with the wife of a Politburo member. She was head of a government office responsible for overseeing Xiamen's trade when the smuggling ring was active. It is hard to imagine that she did not know what was going on. But investigators kept their distance to avoid embarrassing top leaders.

In 1998, He Qinglian angered some leaders with her book “China's Pitfall” and its powerful description of what she (daringly at that time) called “systemic corruption” in China. She fled the country last year. This year, an annual report on Chinese society published by her former associates, the Chinese Academy of Social Sciences, gave warning that “unless the problem of corruption is genuinely tackled as a systemic issue, it could become the main cause of social turmoil”. It said that 67.3% of respondents to a survey the academy carried out last year believed that political reform was urgently required.

For all the party's tough words on corruption, and occasional high profile sentencing and even executions, in the minds of many officials the potential gains from corruption still far outweigh the risks. In a paper published last year, Hu Angang and Guo Yong of Beijing's Qinghua University estimated that 10-20% of corruption cases are solved and only 6.6% of party officials who are disciplined for corruption receive any criminal punishment. Officials are normally only prosecuted for corruption in cases involving more than 2,000 yuan ($240). An ordinary citizen could be jailed for stealing public property worth considerably less.

Corrupt earnings continue to account for a significant proportion of the billions of dollars of illegal capital flight from China every year. Some Chinese scholars estimate that annual capital flight climbed from $10 billion to more than $45 billion between 1991 and 2000. President Jiang could perhaps point to one dubious sign that people are taking note of his anti-corruption efforts. An official journal noted, “As the severity of China's crackdown on corruption intensifies, this illegal capital is all the more desperate to flee.”

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The Koreas

Escape to the south

Feb 14th 2002 | SEOUL
From The Economist print edition

But it is a problem settling in

FOR 16-year-old Lee Song Chol this should be an agreeable time. He has managed to escape from North Korea. In South Korea millions are celebrating the lunar new year. New year's day, February 12th, is a time of family reunions. Koreans travel long distances to be together. But Lee's family is cruelly divided. A sister and his aunts remain in the North. He thinks it unlikely that they will be having a good time. Although the North also has a lunar holiday, the young Mr Lee remembers only the privileged being able to afford to celebrate it. He acknowledges that he is one of the fortunate ones, with enough to eat and a degree of freedom unknown in the North. All the same, it can be a lonely life, although it is one experienced by hundreds of other northern defectors who have found that life in the rich South is not quite as they expected.

AP

Yes, you made it

Most assumed that in a prosperous country there would be plenty of work. But in a recent survey of 533 defectors about a third said they had been unable to find jobs. Some are simply not streetwise to the ways of capitalism. The government seems to be aware of the problem. It seeks to protect the northerners after their grim experiences. All defectors have to stay for three months at Hanawon, a training centre, to learn the basic skills needed for daily life: how to use a bank, and so on.

What they cannot teach is self-confidence. Many defectors suffer from low self-esteem, says a Seoul psychologist. Three out of five in the survey said they believed that southerners despised them simply for being northerners. They were certainly not regarded as heroes. Because of their strong northern accent, they were wary of speaking to southerners for fear of being mimicked. Northern children are often kept apart in school from other children until they learn a southern accent.

In some ways the Korean peninsula, divided for more than half a century, now has two cultures and two languages. Many northerners have found it difficult to pick up the South's modern vocabulary, which is full of words borrowed from English and Chinese. Nor do they seem to understand the character and spirit of capitalism. A social worker in Seoul says that they are so used to getting strict orders about everyday matters, they lack self-motivation. They even expect the government to feed them.

Resentful southerners say that is just what the government does do. As the number of defectors has risen so has the bill for easing them into southern life. It nearly doubled last year to 20 billion won

($15m) as the number arriving rose from 312 in 2000 to 583. The number this year is expected to be up by about a fifth on last year. A defector receives the equivalent of $22,600, more if there are dependants, together with rent-free accommodation, health care and other social benefits. Some claim that it is not enough, but the government's purse is limited, given that millions of southerners are poorly housed and thousands of graduates cannot find work.

Defectors are desperate for money to hire an agent who will devise ways to bring their relations to the South. They will pay $15,000 or more for the service, which includes a forged South Korean passport and safe transport. In recent years, nearly all defectors who landed in South Korea had spent at least a few months in China. Tens of thousands of northerners are believed to have crossed into north-western China. It is a tough border patrolled on both sides by guards who try to prevent them crossing. Those who make it into China are sometimes so discouraged that they return to the North after scavenging for food. Some remain indefinitely in China. A relative few make it all the way to Seoul.

Because of his youth, Lee Song Chol has a better chance than many of adjusting to life in the South. Loneliness at least is not going to be so much of a problem in the future. Lee used a lot of his government grant to pay an agent to rescue his mother who has recently arrived in Seoul after spending four years in China.

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By broomstick to Tokyo

Potter's Japanese adventure

Feb 14th 2002 | TOKYO
From The Economist print edition

The magic way to brush up your English

EPA

But how do you pronounce Slytherin?

THE amazing Harry Potter seems to have cast a spell on Japan. Not only are the Japanese reading large numbers of J.K. Rowling's books in translation, but they are devouring them in English too. Kinokuniya, Japan's biggest bookstore chain, says that almost a fifth of the 220,000 Harry Potter books it sold last year were in English. Maruzen, another big bookstore, says that although sales of most English-language books tail off after the first couple of months, demand for English Harry Potter books is still rising steadily.

Bestsellers in Europe and the United States, say by John Grisham or Agatha Christie, often do well in Japan too, but mainly in translation. In English they are unlikely to fly off the shelves of bookshops. The Harry Potter stories are reckoned to be an easy read and seem to appeal to adults as well as children. Bookstore staff say that if you have learnt English up to secondary school level you should be able to cope with Potter.

Educationalist are particularly pleased that thousands of Japanese who let their English slide are brushing up their vocabulary, given a flying start by Potter's broomsticks. Potter audio cassettes help with the harder English words. Bookshop managers believe the books are persuading customers to summon up their courage to sample other foreign books and magazines. It's magic, they say.

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Malaysia's foreign workers

But who will do the dirty work?

Feb 14th 2002 | KUALA LUMPUR
From The Economist print edition

Immigration and its problems

THE run-up to Chinese new year should be one of Malaysia's biggest shopping seasons. Yet the day before the holiday, the streets around Kuala Lumpur's Chow Kit market were strangely quiet. Hardly any traders spread their wares along the pavement for eager shoppers. It is not that Malaysians are trying to cut back on spending; rather, their government is trying to cut back on the migrant workers who do the selling, and on foreign labour in general. It has launched one of its periodic crackdowns on illegal immigrants, like the street hawkers of Chow Kit, and repeated plans to phase out even their properly documented counterparts. The intention is to reduce crime, preserve jobs for locals, and promote more capital-intensive industry. But the result of the crackdown might turn out to be just the reverse.

Malaysia has always relied on foreign labour: its substantial Chinese and Indian minorities first arrived in the country in colonial times to work in its tin mines and rubber plantations. Nowadays, Indonesians form the bulk of both the 800,000 legal foreign workers, and the million-odd illegal ones. Like migrant labourers everywhere, they do the dirty, dangerous and demeaning jobs that no one else wants: washing dishes, laying bricks and tending oil palms in the muggy equatorial air. And like locals everywhere, their Malaysian hosts look down on them as supplanters of local labour and probable criminals.

When a number of Indonesian workers rioted during a drugs raid on a Malaysian factory last month, the locals reacted with self-righteous indignation. The government said it would halve the number of Indonesian workers in Malaysia and put the country to the bottom of the recruitment list in future. Foreigners in general would be allowed to work only on plantations and as maids, and only for three years at that. Illegal workers and their employers would face whipping if caught. In order to intercept would-be migrants, the authorities promised to impose tougher visa requirements and to beef up the coastguard. In the Malaysian portion of Borneo, police quickly pledged to round up and deport 40,000 illegal workers.

This hue and cry has doubtless gone down well with more blinkered Malaysians. But the government will find it hard to follow through on its stern talk. A narrow strait, 500km long, separates peninsular Malaysia from Indonesia, not to mention a long border on Borneo. The two countries have not been able to stamp out piracy, let alone stem the flow of migrant workers. The recent escape of over 150 illegal aliens on their way to jail has helped to highlight the difficulties faced by police. Anyway, Malaysia needs the workers. Although some have lost their jobs and turned to hawking amid the current recession, most are gainfully employed. Construction, in particular, relies on foreign labour. It was recently disclosed that illegal immigrants were even helping to build a new prison. And Malaysian firms, already struggling amid the recession, can ill afford to put in technology to replace labour, as the government is urging them to do.

Indeed, the government's vision of a high-tech future (without any need for grubby foreigners) might actually do more harm than good. Since Malaysians spurn the sort of work immigrants do, getting rid of them won't generate jobs acceptable to locals. But keeping them in the country lowers the cost of doing business in general. What is more, the relative diversity of Malaysia's economy, complete with a big agricultural sector, has saved the country from a deeper downturn. Over the past year, as Malaysia's electronics exports have plummeted, the price of palm oil has risen—but not the pay of the workers who harvest it.

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Religion in India

Temple trouble

Feb 14th 2002 | AYODHYA
From The Economist print edition

A test of tolerance

IT IS not India's Jerusalem or its Mecca. India itself is a holy landscape, dappled with sacred cities, shrines, rivers, even trees. Yet Ayodhya is where Hinduism, the normally tolerant religion of most Indians, is at its most contentious and political. It is the birthplace of Ram, one of ten incarnations of Vishnu, the world-sustaining member of Hinduism's highest trinity.

Ten years ago Hindu activists tore down a mosque that Muslims had built in the 16th century on the very place claimed to be where Ram was born. Its destruction was the culmination of a campaign that sparked clashes between religions across India. On March 15th, the activists say, will begin the denouement: the erection of a mandir (temple) where the mosque used to be. Nearby, some 50 craftsmen are already carving into blocks of sandstone the intricate splendour that such a holy spot demands.

The start of construction would provoke a full-bore crisis. The Bharatiya Janata Party (BJP), the senior partner in India's 19-member ruling coalition, became a major force thanks largely to its championship of the mandir movement. In power, it has less appetite for trouble. The trouble will be all the greater if construction begins illegally, on land the government acquired pending resolution of a court case over title to the site.

To its champions, the mandir represents not only worship but redress for the humiliations meted out to Hindus and their gods by Muslims, who raided India and ruled it until the British took over in the 18th century. To build it would be to reclaim India's pre-Muslim identity.

According to Mahant Paramhans Ramachandra Das, a 90-year-old priest who heads a trust that is to oversee construction, “India's identity” is through Ram, Krishna and Shankar (or Shiva, the world-destroying member of the trinity). The mandir's foes have a different notion of identity, which sees India as the homeland no less of 130m Muslims than of 800m Hindus and demands that the state respect its constitutional obligation to promote no religion.

Kuldip Nayar, a respected journalist, wrote recently that “beginning temple construction by force may squeeze out whatever is left of our claim to [be] a democratic and pluralistic nation”. Although the mandir's men in Ayodhya say that building will begin in mid-March with the movement of stone pillars to the site, many people doubt it. They detect a sham squabble, cooked up for the state elections that are taking place this month, between the BJP and such sister organisations as the Vishwa Hindu Parishad (World Hindu Organisation) or VHP, which insist the temple will be built.

The VHP wants construction to begin not on the birth site itself, the subject of a 50-year-old lawsuit that could drag on for years, but on 67 acres surrounding it, which the government took over in 1993 to forestall trouble. The prime minister temporised; he referred the matter to his law minister.

Abhishek Singhvi, a spokesman for the opposition Congress party, notes that temple deadlines often appear before elections and vanish afterwards. The current one “will pass yet again”, he predicts. Much may depend on whether the BJP or a “secular” rival wins the election in Uttar Pradesh, Ayodhya's state and the largest one in India. Ordinary folk in Ayodhya talk not of imminent construction but of the loss of pilgrims, a source of money driven away by stifling security measures introduced after India's parliament was attacked in December.

To approach the temple site you walk a circuitous trail enclosed in a steel cage surrounded by armed security forces. Suraj Lal Gupta, a shopkeeper, says he has lost three-quarters of his business. A real temple would bring the pilgrims back, its promoters say. But commerce is secondary, as are the opinions

of ministers and the fortunes of politicians. “The way I demolished the structure I'll take the land,” declares Mahant Paramhans. Secularists hope he is bluffing.

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Opium futures

Rush to market

Feb 14th 2002 | KUNMING
From The Economist print edition

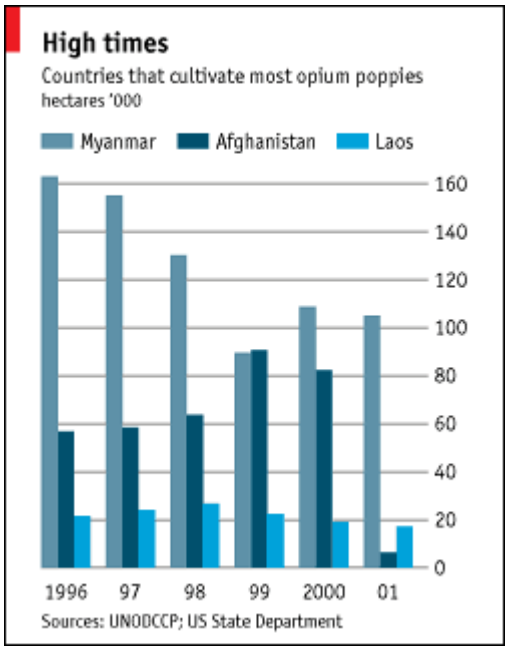
"Out of season" planting by farmers

Get article background

THE opium growers of Asia are busy. Satellite pictures of the highlands of Myanmar, China, Laos and Thailand show furious activity in the poppy fields even though it is rare to produce opium in the dry season. Opium poppies need a lot of water. Farmers are using irrigation on a massive scale to raise the crop. They want to take advantage of the rising price of raw opium, the precursor of heroin, which has doubled from around $450 per kilo last summer to more than $900 now.

The price started rising when the Taliban stopped Afghan farmers growing the opium poppy. After the American bombing of Afghanistan and the fall of the Taliban, Afghan farmers prepare to resume growing their profitable crop. Opium producers elsewhere in the region want to market their product before a new Afghan supply brings the price down.

Myanmar aims to keep its place as the world's biggest cultivator of the opium poppy (see chart). As a result of peace deals signed between the government in Yangon and ethnic militias, poppy farmers feel safe from harassment. The so-called United Wa State Army, which produces both opium and amphetamines, operates untouched in north-east Myanmar. Government soldiers have to ask permission from the Wa to enter its territory.



Improved roads to China's Yunnan province, which borders Myanmar, enable the Wa to move opium and heroin through China and Laos and so to the West, rather than using previous, and more risky, routes through Hong Kong and Bangkok. China is worried by the growth of drug taking among its population and the police do make regular seizures: 12.3 tonnes of heroin last year, much of it near Kunming, Yunnan's capital. But a lot gets through, to domestic and overseas markets. Drug usage is soaring in Kunming and Shanghai.

Myanmar, seeking respectability, has also made some token busts of drugs laboratories to appease China, one of the ruling junta's few friends. Myanmar has also recently opened an anti-drugs museum. It was partly paid for by a Burmese who made a fortune selling drugs.

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Yemen and its Islamists

Could Yemen's calm be threatened?

Feb 14th 2002 | SANAA
From The Economist print edition

AP

If its president joins the war on terror too enthusiastically

Get article background

A POSSE of dinner-jacketed Yemeni ministers stood in line to greet their guests. Together they supped on an eight-course banquet, entertained by a troupe of Yemeni dancing girls, while tribesmen cavorted with daggers. And this was just for CNN. With American journalists enjoying such a reception, Yemenis are wondering to what lengths their government is going to please its official American guests.

This week the commander-in-chief of Central Command, General Tommy Franks, and his predecessor, Anthony Zinni, both visited Yemen, to install a fresh contingent of FBI officers. They followed fast on the heels of a group of American military advisers, arriving to train the Yemeni coastguard and security forces. It is all a marked reversal from the recent past. After the bombing of the *USS Cole* in October 2000, the American navy abandoned its port facilities in Aden. Yemen became the only country in the Arabian peninsula without an American military presence.

The Americans have returned, says Edmund Hull, America's ambassador, to hunt “the key cogs in the machine that makes the al-Qaeda mechanism work.” The FBI's warning this week that a cell led by a Yemeni was plotting attacks on American targets revived fears that the country was providing a shelter for al-Qaeda militants. One suspect blew himself up this week while being pursued.

Experts say that 4,000 Yemenis were recruited to join the Afghan war against the Soviet Union. Western diplomats say there may have been ten times as many. Neither dispute that, after Saudi Arabia, Yemen was the prime source for Afghan Arabs. Mosques recruited the faithful to join the *jihad*, and in return provided welfare for their families. More important, Yemen—unlike other Arab states which jailed or exiled their returning Afghan Arabs—welcomed them back. In Yemen's 1994 civil war, President Ali Abdullah Saleh recruited Afghan veterans from across the Arab world to wage another victorious *jihad* against the Soviet-backed socialists of south Yemen.

At its height, the Islamist network had its own school system, its own ministries, and even its governorates, including Hadramawt, the bin Laden ancestral home. After the fall of the socialists in the south, the Islamists set about filling the vacuum with their own quasi-Taliban rule, attacking weddings and torching a brewery.

Mr Saleh appointed Abdel Majid al-Zindani, a one-time colleague of Osama bin Laden in Afghanistan, as a

presidential counsellor. The founder of the Muslim Brotherhood in Yemen, Mr Zindani was instrumental in converting the northern tribes to the puritanical Islam of the Saudis, and turning tribal areas outside government control into Islamist heartlands. Until recently, Mr Saleh presided over the graduation ceremonies at Al-Iman, Mr Zindani's university in Sanaa and the last known address of John Walker Lindh, the American Taliban fighter, before he was captured in Mazar-i-Sharif.

Even today, Yemen remains one of the rare Arab states that integrates rather than suppresses its Islamists. They have their own political party, Islah, the country's largest opposition party, with 64 of 301 seats in parliament. Their members have penetrated the Political Security Office, Yemen's intelligence service, and the army. They retain their own military wing.

Will the Americans now oblige the government to change its ways? They insist that they are returning to Yemen at the behest of the Yemeni authorities, not dictating terms. But Mr Saleh is proving a willing student of America's war on terror.

For him, it offers the chance to extend his authority over the mountainous tribal domains. The country's millions of firearms have been banned from cities. And the war on terror has also become a war against the tribal kidnappers, a war that the government is waging mainly by taking the kidnappers' relatives hostage. Since September, scores have been dragged from their houses or arrested in schools. And where once Mr Saleh was *primus inter pares* among the tribal chieftains, Yemenis now speak of a new leadership.

It looks, in short, as if Mr Saleh may want to turn Yemen into a more typical one-party Arab state. Will criminalising the Islamist movement be next? Even before September 11th, independent Islamist schools were banned. The Islamist governors have been sacked. And the state now issues guidelines for Friday sermons.

But Yemen's balance of tribal and Islamist forces has earned it stability; kicking the Islamists out of the political system might turn out to be unwise. Many people already fear a backlash. When the state published the photographs of two Yemenis wanted for helping Mr bin Laden, their tribal hosts were quick to cite traditions of hospitality for declining to hand the men over. Target an individual, they say, and you risk targeting a tribe. A war on Islamists could cost Mr Saleh the tribal backing on which his legitimacy depends.

Until now, the president has stepped back from the brink, choosing to jail the soft target of foreign students rather than his own people. Islamists have been ordered to lower their profile, and not to speak to the press. We paid heavily for our verbal support for Iraq in the Gulf war, Mr Saleh told Islamist and tribal leaders. We will not make the same mistake twice.

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Israel and the Palestinians

Bombs and plans but no new faces

Feb 14th 2002 | JERUSALEM
From The Economist print edition

As the Israeli-Palestinian conflict rages on, a number of plans are floated

AP

A rather uncommon Israeli

"ARAFAT is not a partner, and won't be a partner," Ariel Sharon told his American hosts last weekend. The Israelis "have to deal with the Palestinian people, who elected Yasser Arafat," replied Mr Arafat, from his besieged offices in Ramallah. Who is winning this tussle? Mr Arafat, perhaps. While agreeing with Mr Sharon that Mr Arafat must do more to root out terrorism, George Bush did not accept his idea that there is an alternative leadership in the Palestinian Authority (PA) ready to quell the *intifada*. And other American leaders wondered whether Mr Sharon's penning of Mr Arafat into Ramallah was not strengthening him elsewhere.

It is in Europe. At a meeting on February 9th, the European Union's foreign ministers sharply criticised Israel's ostracism of Mr Arafat. They also criticised America's general tacit approval of the way that Israel is countering violence, an approval that, in practice, is granting enormous latitude to Israel's gradual reconquest of Palestinian-controlled land.

The next day the conflict spiralled into yet new violence. The latest cycle was set off when Hamas killed two women soldiers near an army base in Beersheba. Hamas then pitched two homemade Qassam-2 rockets, with a 5kg (11lb) payload and a five-mile range, from Gaza into Israel, despite urgings from the PA to desist, and warnings from Israel that such action would be construed as "an act of war".

Israel's response was to send F-16 jets to bomb Gaza city, ostensibly to destroy PA security buildings and "mortar factories", but in fact sowing terror among the 500,000 Palestinian civilians who live in the thickly-populated town, and causing massive damage to their properties and institutions, including the offices of the UN's representative in the West Bank and Gaza. Israel then sent its tanks into the West Bank and Gaza to carve out new "security zones". Six Palestinian policemen were killed in the raids. Some of the tanks will stay "until it is clear there is no more risk" of rockets being launched, said Israel's defence minister, Binyamin Ben-Eliezer.

The assaults from without were accompanied by chaos within, as Palestinians stormed PA prisons in Gaza and Hebron to free Hamas and Islamic Jihad prisoners interned in them. Mr Arafat says there is nothing he can do stop this anarchy so long as he is incarcerated in Ramallah. And Muhammad Dahlan, the security chief in Gaza whom Israel has touted as a "pragmatic" possible successor to Mr Arafat, added that he can do nothing to prevent prison-storming so long as the PA's prisons and police stations are deemed legitimate targets for Israeli attacks.

European leaders, alarmed by all this, have come up with various plans. The French have proposed a plan based on Israel's withdrawal from PA-controlled areas, early recognition of a Palestinian state, and new elections in the occupied territories to renew Mr Arafat's mandate as a leader and peace partner. On the other hand, the British, whose foreign minister, Jack Straw, visited Mr Arafat on February 13th, still support the American line that a ceasefire must precede any return to talks.

Where the Europeans agree is in arguing that the status quo cannot hold, and that Mr Arafat remains the only Palestinian with enough of a following to change things. "No people will allow themselves to be dictated to by the other side as to who their legitimate leader is. And so long as that is Mr Arafat, one will not be able to push him aside," said Joschka Fischer, Germany's foreign minister, who was also due to

visit Mr Arafat on February 14th.

The Palestinians, in desperate plight, welcome all envoys and most plans. These now include an Israeli-Palestinian one: an unsigned and unpublished document concluded by Shimon Peres, Israel's foreign minister, and Ahmed Korei (Abu Ala), the speaker of the Palestinian parliament. It envisages a four-phase process: four weeks to reach a stable ceasefire, during which Israel would pull back to its pre-*intifada* lines; eight weeks for Israel and a Palestinian state to recognise each other; a year to negotiate a comprehensive peace treaty between the two states; and two years to implement the treaty.

Mr Peres has begun hawking the plan around the political parties, and explaining it to the public in a series of interviews. He hopes in this way to soften Mr Sharon's objections, and also to outflank the sizeable scepticism in his own Labour Party. Some Labour members have joined the small but growing cross-party ginger-group that advocates unilateral Israeli withdrawal from most of the territories, and the construction of a strongly defended border fence. To Mr Peres, who believes there is still hope of talking peace with Mr Arafat, who knew, and approved, of his negotiations with Mr Korei, unilateralism is a counsel of despair.

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Madagascar's election

Sulking in his tent

Feb 14th 2002
From The Economist print edition

Strikes, protest and the lust for power

EPA

We woz robbed

“THERE were many, many problems” with the election on December 16th, says Madeleine Lamaholimihalo, who led the groups monitoring Madagascar's polling stations. They found old electoral rolls, unequal chances to campaign and logistical problems in rural areas. But was it so bad that the result, which allows for a run-off this month between the president and his opposition rival, should be cancelled?

Yes, say the 100,000 or so Malagassy who brave tear-gas each day. Since mid-January, huge crowds have blocked the narrow streets of Antananarivo, the capital. Two weeks ago, protesters also declared a general strike. Both the strike and the protests will go on, say their supporters, until the High Court reverses its ruling that the first round was broadly fair.

The opposition favourite is Marc Ravalomanana, a grocer-tycoon who is also Antananarivo's mayor. His slick campaign was promoted on the back of his “Tiko” brand of dairy goods and bottled water. Official figures gave him 46% of the vote, against 41% for the incumbent, Didier Ratsiraka. But Mr Ravalomanana says there was fiddling, and that until there is a recount, the first round has not ended.

Does all this condemn the sitting president? Not altogether. The opposition has shown no evidence of large-scale rigging, nor that its man got over half the votes, which would have been enough to win on the first round. And while Mr Ratsiraka is again campaigning heartily, his young rival sulks at home, refusing to take part in the second round, due on February 24th.

Outsiders are trying to help. A stream of foreign dignitaries, including delegates from France, the UN and the African Union (the new name for the Organisation of African Unity) made it to the island this week. Amara Essy, the African Union's secretary-general, suggested that the second round be postponed until conditions are better. He also persuaded Mr Ratsiraka and Mr Ravalomanana to meet, which they did on February 13th.

But success may still be unlikely so long as both candidates hope to benefit from the impasse. Mr Ratsiraka who first took office in 1975, tells voters that he offers stability, growth and jobs, while his rival brings chaos and strikes. Mr Ravalomanana reminds people that the president fled office once before, in 1991, when public protests were prolonged and bloody.

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Angola's war

From a scorched land, a hint of peace

Feb 14th 2002 | LUENA
From The Economist print edition

But Angolans, weary of war, are deeply sceptical

NOBODY bothers to look up as helicopters rumble over Luena, an isolated town in eastern Angola. Some are carrying soldiers to the front line in the war against the rebels of UNITA. But at least as many are plucking peasants out of the war zone and ferrying them to camps around Luena. By emptying the countryside, the army hopes to starve out the rebels, who live by looting or forcing the locals to hand over their crops.

Each day, about 100 people arrive in Luena. Those who come in military trucks or helicopters appear to have had little say in the matter. Some tell of being captured while working in their fields, and bundled directly into a helicopter. But others come voluntarily, on their own bare feet. Life in the relative security of a refugee camp, they have decided, is better than the gun battles and pillaging that torment rural life. Women far outnumber men, testimony to the fondness, of both the army and the rebels, of conscripting men at gunpoint.

But the rebel leader, Jonas Savimbi, remains at large, and UNITA still attacks towns in Moxico and the central plateau, as well as making incursions into the government's north-western heartland. From time to time, President Jose Eduardo dos Santos reiterates that his government is on the brink of wiping out the rebels and capturing Mr Savimbi. Nobody believes him, but his words have helped to play down the need to sit down and talk peace.

It was in these inauspicious circumstances that the UN's special representative, Ibrahim Gambari, visited Angola at the end of last year. This was the latest in a series of trips that have seemed little more than courtesy calls on Mr dos Santos. The failure of successive UN peace initiatives in the 1990s has engendered ill-feeling towards the organisation. The UN's Angolan peacekeeping mandate is renewed every six months, subject to the government's agreement, but in the past year or so the UN has been cautious to the point of paralysis. Declarations in the Security Council in favour of maintaining sanctions against UNITA keep the government happy but have, until recently, made it diplomatically impossible for the UN to make even the preliminary contacts necessary for starting a dialogue with the rebels.

However, after Mr Gambari departed, making the usual noises about “progress in the peace process”, it emerged that his visit to Luanda had been preceded by a clandestine meeting with rebel representatives in the United States. Moreover, during Mr Gambari's visit, Mr dos Santos had agreed to the UN having further contact with the rebels.

So progress has indeed been made. But progress towards what? Churches and other independent organisations in Luanda have been arguing that yet another bilateral accord between the government and UNITA is not enough. Such agreements have failed in the past, and there seems little reason to believe that another stitch-up would turn out differently. Instead, this nascent civil-society movement calls for deeper political change. It wants to address the corruption and irresponsibility that characterise the dos Santos regime, a state of affairs that was unaffected by the transition from single-party to multi-party rule in the 1990s.

But the UN envisages the Angolan problem as being between the government and the rebels, with civic organisations marginalised, though they could perhaps play a role as facilitators. And Mr dos Santos, who

has the war to thank for the fact that ten years have now passed since the last election, is too shrewd a politician to allow any move towards a settlement that might challenge the grip that he and his inner group have on power and wealth.

The president finds it politic to show himself open to peace moves. He clearly gave the nod for the talks between the UN and the rebels last year. But the smoke that rises from the scorched earth of Moxico sends the signal that such talks are an optional extra, to be indulged in at the government's own convenience.

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Rwanda's genocide trials

When God was absent

Feb 14th 2002 | KIGALI
From The Economist print edition

Clergymen take their place among those accused of genocide

THE Rwandans have two sayings about God. One is that while he may spend the daytime outside the country, he always comes home to spend the night in Rwanda. The other is that he was absent from Rwanda during the 1994 genocide.

Several men of God, including an Anglican bishop and two Roman Catholic priests, are due to be tried in Arusha, Tanzania, by the International Criminal Tribunal for Rwanda. The latest arrival is Athanase Seromba, a Catholic priest who is accused of having ordered bulldozers to crush his church in Nyange, and the 2,000 Tutsi who had taken refuge inside it.

He gave himself up to the tribunal last week after spending several years under the protection of the Catholic church in Italy. He worked as a priest in Tuscany, then went into hiding last year after the tribunal tried to have him extradited. He has pleaded not guilty to four counts of genocide and crimes against humanity.

The clergyman now on trial, and the first to be indicted, is Elizaphan Ntakirutimana, the former head of the Adventist church in Rwanda. He was arrested in Texas in 1996 and transferred to Arusha in March 2000, after a long legal battle in which his lawyer, Ramsey Clark, a former American attorney-general, sought to prove that his extradition would be unconstitutional. His trial, which began in September, was resumed this month. It is being held jointly with that of his son, Gérard, a doctor. Both have pleaded not guilty to charges of genocide for their role in the slaughter at the Mugonero Adventist church and hospital complex in April 1994.

The Mugonero complex, in Rwanda's western Kibuye province, was the pride and joy of Rwanda's Seventh Day Adventists. Its hospital had an excellent reputation. But, like other churches across Rwanda, Mugonero became the scene of slaughter on an unimaginable scale. The 2,000-5,000 Tutsi who took refuge there, when they saw their homes being set on fire, were shot or hacked to death in a long day of slaughter.

The bill of indictment states that the Ntakirutimanas—whose name means “nothing is greater than God”—were in a convoy of people who on the morning of April 16th went to Mugonero and took part in an attack on the people sheltering in the complex. The document adds that those who survived the attack took refuge in the hills of Biserero nearby, where they were later tracked down and killed.

Elizaphan Ntakirutimana stands accused of having encouraged his Tutsi parishioners to take shelter in his church, and of having ensured that the few Hutu in the complex left before it was attacked. Many of the details are chilling. The day before the massacre, seven Tutsi Adventist pastors, who were looking after the refugees in the complex, wrote thus to their “dear pastor”, Mr Ntakirutimana: “How are you! We wish you strength in all the problems you are facing, and we wish to inform you that tomorrow we will be killed with our families. We therefore ask you to intervene on our behalf with the mayor.”

Philip Gourevitch, a writer, recounts that when he met Mr Ntakirutimana in Texas shortly before his arrest, the pastor was sitting with the original manuscript of this letter in a file on his lap. According to Mr Gourevitch, he claims to have sent the following message back via a group of policemen: “Nothing can be done and the mayor says he can't do anything either.” But the few survivors of the Mugonero massacre have a different story. They say that the pastor replied to them personally, saying “A solution has been found for your problem. You must die.” Or, according to others, “You must be eliminated. God doesn't want you any more.”

The trials are not hurried. Since the Arusha tribunal was created in 1994, just eight people have been convicted, including Jean Kambanda, who was prime minister at the time of the genocide. They have received prison sentences ranging from 12 years to life, which most of them are serving in Mali. One person has been acquitted. Seventeen people are currently being tried in seven different trials.

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Moroccan assassinations

The now unsecret policeman

Feb 14th 2002 | RABAT
From The Economist print edition

A story that has Morocco's politicians worried

EPA

Recounting the daily grind

UNTIL recently, few Moroccans had heard of Ahmed Boukhari, a retired member of a secret-police unit known as CAB-1 (for *cabinet*, or office). His owl-like face is now worryingly familiar, after his detailed allegations about the activities of the unit he once served. Mr Boukhari claims that CAB-1 was created in 1960 to intimidate, torture or kill members of the opposition. This week the titbits he has already made public were filled out in a 320-page book published in France, "*Le Secret*" (Michel Lafon, Paris).

According to Mr Boukhari, CAB-1 carried out the assassination of opposition politicians and their supporters from 1960 until 1973. The most explosive charge concerns an exiled socialist, Mehdi Ben Barka, who is still revered by many Moroccans but who vanished in Paris in 1965. The French have reopened a judicial inquiry into his disappearance. Mr Boukhari claims that Ben Barka was killed on the orders of those at the top of the Moroccan secret services, with the approval of cabinet ministers.

Mr Boukhari tells of the daily grind of the torturers at their interrogation centre in a Rabat suburb; they apparently stopped off at a grocery store each morning for red wine to fortify them in their work. He claims that CAB-1 not only had the collusion of some senior left-wing politicians but also ran a network of informers who included members of the conservative Istiqlal party. However, he carefully names no names of politicians still at work. He is currently appealing against a three-month prison sentence on charges of libelling, among others, his former police superior.

It remains unclear how a relative dogsbody would have come to know as much about the secret services as Mr Boukhari says he does. Yet few people in Rabat dismiss him as a mere charlatan. There have been protests against the refusal to give him a passport, which has prevented him from giving evidence at the reopened inquiry in France.

His allegations are a challenge not only to Morocco's secret services but also to its political class. Mr Boukhari's tale of widespread political collusion with CAB-1's operations may be intended, some Moroccans think, to cloud the question of accountability for past brutalities. It creates a world, as one sceptic puts it, in which "everyone has been a victim and everyone a torturer."

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France's presidential election

They're (just about) off!

Feb 14th 2002 | PARIS
From The Economist print edition

The presidential campaign is beginning in earnest, with no clear winner in sight

Get article background

“WHAT motivates me is passion. I love France. I love the French.” Will such an unashamed declaration of devotion, made for the television evening news on February 11th, help secure Jacques Chirac a second term as the president of a nation that—by weight of its culture, economic prowess and nuclear warheads—considers itself first among equals in the European Union? Or will the voters spurn Mr Chirac's overtures, considering him at 69 too old or too tainted by scandal or perhaps simply too bereft of ideas to merit their love in return?

The unhelpful answer is that no one knows. Arguably, this spring's elections, first for the presidency and then a month later for the National Assembly, will be the most important since General de Gaulle inaugurated the Fifth Republic in 1958. Because of a constitutional amendment, which was approved by an unenthusiastic referendum in September 2000, the presidency will no longer be for seven years, but will match the five-year term of the National Assembly.

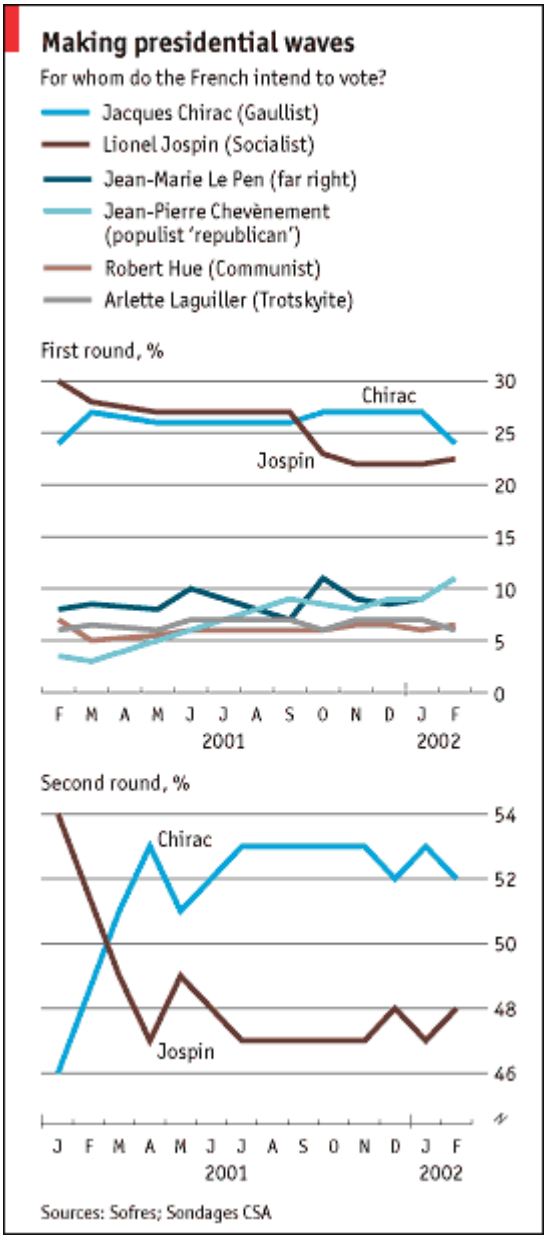
The theory is that this will encourage the voters to choose a president and a parliament of the same political colour rather than the opposing hues of today's France. This team will then have a full five years, uninterrupted by elections of any importance, in which to put expediency aside and attempt the fundamental reforms—of pensions, taxes, education and so on—that are often mooted and rarely tried. It will also steer France through the troubled waters of foreign policy: the EU's enlargement, for example, or the handling of the American “hyperpower” or the role of Europe within NATO.

Yet most voters seem not to care. Only 11%, according to one poll out this week, are “very interested” in the elections and only another 27% are “moderately interested”. Meanwhile, the pollsters, wary of their margins of error, rule the contest too close to call. All that is clear is the timing: the first round of the crowded presidential race will be held on April 21st; the second round between the top two candidates will be on May 5th. The assumption is that this run-off will be between Mr Chirac, founder of the conservative Rally for the Republic party (RPR), and Lionel Jospin, the Socialist prime minister with whom he has been forced to “cohabit” ever since he unwisely called an

early parliamentary election in 1997.

Yet even this assumption could come adrift, in particular because Jean-Pierre Chevènement, once a minister in Mr Jospin's government, is running on a nationalistic, “republican” platform that could take first-round votes from president and prime minister alike. As he rises in the opinion polls, the prospect that Mr Chevènement, as the “third man”, will topple the favourites becomes ever less far-fetched; after all, that is what the late-coming Valéry Giscard d'Estaing did in 1974.

This is not the only assumption that could go awry. So, too, could the notion that a revised electoral calendar will suit Mr Jospin more than Mr Chirac. In December 2000 the National Assembly, whose term was due to expire in April this year, voted by 300 to 245 to extend its life until June. The reason, Mr Jospin's supporters argued, was that it was the presidency that mattered most; it should not be diminished in the voters' eyes by holding the general elections first. Disingenuous tosh, claimed the Chirac camp: Mr Jospin simply wanted to avoid the risk that a parliamentary setback would spoil his presidential chances.



But there is a counter-argument. If the calendar had remained unchanged and the left had done well in the general elections, that would surely have boosted Mr Jospin's presidential prospects. Instead, as things now stand, Mr Chirac, warm and persuasive where Mr Jospin seems cold and austere, may charm his way to victory in April and May and then use the momentum to regain the Assembly for the right in the general elections of June 9th and 16th.

In which case, Mr Chirac's “passion” is not to be mocked. The left accuse him of lacking both ideas and consistency: witness his belated support for the euro, a currency he once decried. They accuse him also of corruption, though there are plenty of skeletons in their cupboards, too, and not just from the Mitterrand era of 1981 to 1995. But even his most virulent critics grudgingly admire Mr Chirac's love of the campaign. So, too, his resilience. After the defeat of the right in the general elections of 1997, Mr Chirac was a marginalised figure: as president he retained titular command of foreign policy and defence, but the power to govern now rested with the power of the purse and so with his opponent, Mr Jospin.

Paradoxically, Mr Chirac has turned that loss of power to his own advantage. Because he has no record over the past five years to defend, he is free to attack Mr Jospin's: crime is growing; unemployment has started rising again; and France is slipping down the EU's league table of wealth per person. All this, he implies in the consensual tones of a president representing the whole nation rather than a particular party, is the government's fault.

A Socialist stratagem needed

So how will the Jospin team reply? The obvious way, given Mr Jospin's image of personal probity, is to point to the scandals dogging Mr Chirac, especially from the period between 1977 and 1995 when he was mayor of Paris. Yet this has its limits: first because Mr Chirac in office is immune from judicial questioning; second because, as he correctly points out, most of the allegations involve a long-gone system of illicit party financing in which the left was as implicated as the right; and lastly because the public, assuming that “politicians are all the same and they're all corrupt”, appears remarkably unmoved.

By contrast, a better way might be a return to rather different basics. Why not, for example, remind the voters that Mr Chirac will be getting on a bit by the time he ends a second term? And why not recall that his first term began rather badly: first the resumption of nuclear tests in the Pacific and then the massive strikes provoked by the mishandled reforms of his prime minister, Alain Juppé, an RPR stalwart known

more for his brains than his common sense? And, lastly, why not indulge in some populist propaganda, noting that in the teeth of right-wing opposition Mr Jospin's government has shortened the working week to a mere 35 hours for the same pay as the 39 under Mr Juppé?

It may be that Mr Jospin will coyly remain merely “a probable candidate” for a few days more, but with Mr Chirac's official announcement—in Avignon, just before his television interview—of his candidature, the “phoney war” of the election campaign is finally over.

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A presidential also-may-run

A small white hope

Feb 14th 2002 | PARIS
From The Economist print edition

A French businessman with good ideas but no hope of implementing them

Get article background

CAN Christian Blanc, a former civil servant who is now boss of Merrill Lynch in France, rescue the country from its political apathy? Probably not, since a new opinion poll reckons that 62% of potential voters hardly give a fig for the coming presidential and parliamentary elections. But at least the cigar-smoking Mr Blanc is trying to shake up the campaign with a strategy of public meetings and Internet petitions, though it is unclear whether he will actually join the race formally.

In any event, his big idea is that France's next president should within four months of the election call a national referendum to free the nation from the deadening hand of its civil service: a quarter of France's workforce are in the public sector and half of its MPs are on leave from the civil service.

The aim is to "modernise French society" with five separate measures that would be endorsed by the people:

• Elected officials would be forbidden from having several jobs at the same time—for example, being simultaneously a mayor, a regional councillor and an MP; they would also, to encourage candidates from all walks of life, be given financial help if their political career should abruptly end.

• Nationwide referendums would be called at the request of 1m signatories and local questions posed at the say-so of a tenth of a community's voters.

• Most public services would be managed at a regional level, leaving the state to concentrate only on foreign policy, defence, justice, health and "strategic" issues, such as energy policy.

• A new civil-service statute would be drawn up for those dealing with national "missions" such as defence and justice; other public employees would make do with normal work contracts.

• Whatever the "social conflict", public services, especially transport, would by law have to maintain a minimum service; so in certain areas strikes would be curbed.

All of which in theory is common sense. Practice, of course, is another matter. No one doubts the 59-year-old Mr Blanc's talents. As a civil servant he advised Michel Rocard, a Socialist prime minister; helped end separatist violence in New Caledonia; modernised the Paris subway and bus system; and faced down the unions to bring Air France into profit, before resigning as its boss in 1997 when the new prime minister, Lionel Jospin, refused to privatise it.

But with no party machine, what price a bid by Mr Blanc himself for the presidency? A businessman who agrees with his ideas nonetheless laughingly plays on Mr Blanc's name and the opportunity for the French voter to cast a blank ballot: "To vote Blanc [white] is to vote for nothing."

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Italy and corruption

Is there less than before?

Feb 14th 2002 | MILAN
From The Economist print edition

Ten years after anti-corruption trials began, Italians have lost interest

IT ALL started on February 17th 1992, when the manager of an old people's home in Milan was caught red-handed, taking a bribe. So it is ten years since the start of Tangentopoli (Bribesville), as the rash of scandals that shattered Italy's old political and business establishment came to be known. Rows over the judiciary and trials over alleged corruption are still common; indeed Silvio Berlusconi, the tycoon who is Italy's prime minister, is himself on trial. Magistrates have been complaining bitterly that the government is interfering with their work. The interior minister has sued Milan's chief prosecutor. Does this mean that Tangentopoli is alive? It does not. It is over.

Eight former prime ministers and some 5,000 businessmen and politicians were charged. Some of the corruption was on a grand scale: one senior health ministry official was found to have pocketed $130m. Within two years of Tangentopoli's start, the two chambers of Italy's parliament had received requests for immunity to be lifted on 619 members, of whom 321 were investigated. In Milan, only about 15% of the businessmen and politicians put on trial were acquitted after being found “not guilty” first time round, though more than half eventually got off—or are still likely to get off—by statute of limitation, and most of the rest were let off on appeal. Ten years on, across Italy, none of those convicted is still in jail; one is under house arrest. A few trials are still going on, including some involving Mr Berlusconi and his companies. But for the most part, according to a top Milanese prosecutor, the *mani pulite* (clean hands) campaign was over by 1998.

In any event, most Italians are fed up with it all. Few still follow the trials with much avidity. Many think now that Tangentopoli was politically motivated, and decry it as a “Communist plot”. Some parties, they point out, such as the Christian Democrats and the Socialists, were wiped out, while others, such as the (ex-Communist) Democrats of the Left remain unscathed. That so many Italians take this view is a victory for Mr Berlusconi, who has relentlessly promoted it in the many media outlets that he owns. Plainly, his own judicial entanglements did not prevent him from winning a huge endorsement at the polls when he won a general election with a landslide last summer.

It would be quite wrong, however, to argue that Tangentopoli changed nothing. It certainly revealed the depths of corruption in Italian society. Many Italians knew that bribery was a way of life across the country and in most industries, in the south more than in the north, in the public sector more than in the private one. Many hated that system but thought they could do nothing to change it. Others, especially in business, learned to live with it, taking comfort from the belief that other European countries suffered from a similar malaise. But when, ten years ago, Milanese magistrates started to round up suspects, people rejoiced. (By the way, Tangentopoli started in Milan because it is Italy's most civic-minded city, not its most corrupt.)

These days corruption, though still common, is less pervasive. One recent example is the cost of public building projects. Before Tangentopoli, says a Milanese magistrate, 1km of railway tunnel under Milan cost 80 billion lire (then worth $67m); today it costs 44 billion lire ($20m).

Some Italians who cheered the magistrates were, and still are, on the left—especially supporters of the former Communist Party. Embarrassed by their long friendship with the Russians, whose empire had collapsed just before Tangentopoli got going, Italy's ex-Communists jumped eagerly on the bandwagon. Since their party (like the post-fascist National Alliance) had never been in power at the national level, its opportunities for feathering its nest had been sparse. The Communists' sins were moral rather than pecuniary. They made excuses for blood-stained left-wing dictators and they did indeed take money from Moscow, but generally for their party rather than out of personal greed. Some Socialists and Christian Democrats, on the other hand, arranged for taxpayers to finance the good life, with swish houses and

secret accounts abroad.

Many of the magistrates were, and still are, both brave and impartial, and by no means all those who campaigned against corruption were on the left. But the trouble is that many of them have indeed played politics. The magistrates' self-ruling body is elected partly along political lines. Some, like the celebrated Milanese prosecutor, Antonio Di Pietro, entered party politics. Moreover, some prosecutors campaigned against corruption more eagerly than others—and most of them had been a lot too quiet before 1992, when they overlooked the corruption that then prevailed. Defendants in Milan had a harder time than those in other cities, and still do.

Ten years after Tangentopoli began, its worst aspect is the law's inefficiency. Trials drag on for ages, often until defendants are let off by statute of limitation, as has happened in several of Mr Berlusconi's cases. This is good for lawyers but bad for justice. No wonder many ordinary Italians have lost respect for their justice system and are bored by anti-corruption trials, which have become, in many Italian eyes, a bit like a second-rate football match.

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The EU stability pact

Promises, promises, fudge, fudge

Feb 14th 2002 | BRUSSELS
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Germany escapes an EU reprimand for its big budget deficit

THE fight was fixed, as everyone knew it would be. At 2.7% of GDP, Germany's likely fiscal deficit for 2002 comes close to the 3% limit laid down by the European Union's "stability pact". Pedro Solbes, the European Union's commissioner for economic and monetary affairs, had threatened the Germans with a formal "early warning". But you don't do that sort of thing to serious heavyweights. When Mr Solbes asked EU finance ministers for their backing, only the Netherlands, Austria, Belgium and Finland agreed.

Once it was clear that the commission could not win enough support, attention turned to saving its face. Hans Eichel, Germany's finance minister, offered solemn "commitments" that it would not breach the 3% limit, and would implement this year's budget plans with care; nay more, the budget would be close to balance by 2004. Po-faced, his equivalents—knowing full well that 2002 is an election year in Germany—unanimously agreed that no early warning was needed, while adding that the stability pact was very important and the early-warning mechanism which they had just declined to operate an essential part of it. Through gritted teeth, Mr Solbes muttered that Germany's commitments met the substance of his concerns.

Portugal, also under threat from the commission, was similarly spared; not because its defence was stronger (as arguably it is), but because the ministers could hardly be seen bashing a poorish small country while sparing a richer big one. Whether either should have been at risk at all is another matter: Gordon Brown, Britain's finance minister, having beaten off commission criticism of his own spending plans, said there was growing support for a less mechanistic view of the stability pact, taking greater account of the economic cycle and of the levels of investment and public debt. Mr Solbes said his interpretation of the pact would be "the same tomorrow as today and yesterday".

No matter, Didier Reynders, the Belgian finance minister, claimed the big thing had been Germany's promise of near-balance by 2004. Just two weeks earlier, the Germans had said this would probably not be possible until 2006, and the commission's analysts had agreed. But that was then; this is now, isn't it?

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Power in Russia

The president's ear

Feb 14th 2002 | MOSCOW
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Who are the men that help Vladimir Putin run Russia? And are they good at it?

GOOD tsars surrounded by bad courtiers are part of Russian history, at least in popular memory. There is little doubt these days that most Russians like their president, Vladimir Putin. Such dissatisfaction as they may still feel with their daily lives they dump on his advisers and top officials. But who are these?

The most important is clearly the prime minister, Mikhail Kasyanov. Widely written off as a stopgap when he was appointed, he has proved loyal to the president and efficient at managing the government. The shadow of his past career, when he was a foreign-debt negotiator friendly with the murky clan that ran President Boris Yeltsin's administration, means that he is still dispensable—which suits Mr Putin nicely. Alexander Voloshin, another old-timer from Mr Yeltsin's team, still has the job of running the president's powerful in-house bureaucracy.

Next come the “power ministries”: nothing to do with electricity but everything involving state might. Here Mr Putin relies heavily on Nikolai Patrushev, who heads the domestic security service, better known by its initials, FSB; and on Sergei Stepashin, a former prime minister who also hails from the Soviet intelligence service and now runs the state audit chamber, a watchdog.

It is in this shadowy world of flexible laws, intimidating behaviour and incriminating documents that the real battle for power and money in Russia is fought out. Mr Putin's main success of the past year has been in hacking back the influence of Mr Yeltsin's friends, who ran swathes of the economy with impunity.

But creating a decent system of law and order to make ordinary Russians more secure is still far off. Crime is rising. Russia has more murders per head than any other country in the world, bar South Africa. This week Mr Putin chided the people who run the notoriously incompetent, brutal and self-interested criminal-justice system. In an elegant backhanded compliment, he commended the prosecutor-general's office for being so critical of its own manifold shortcomings. An impressive young Kremlin official, Dmitry Kozak, has the unenviable task of dragging Russia towards legality.

The next big area where Mr Putin is seeking progress is the economy. Here his personal adviser is a lively economist, Andrei Illarionov, whose free-market ardour often puts him at odds with four others who bend the president's ear on the same matter: Mr Kasyanov; Anatoly Chubais, a political fixer who now runs the state electricity company; German Gref, the disorganised but well-meaning minister for economic reform; and Alexei Kudrin, the dull but competent finance minister.

Mr Putin himself takes a wide range of soundings, usually backs the government, and sticks to generalities when talking about Russia's policy in public. To catch up with the West, he rightly says, the country must get foreign investment and do business more honestly. When he intervenes directly, as he did last year when he sacked the head of the state gas company, Gazprom, he is swift and ruthless.

But this year's chillier economic climate (see article) may pose much harder choices. Russians will be paying a lot more for their housing and heating. A cash squeeze on local government means that many state-sector workers are again getting their wages late. There are worrying ripples of wildcat strikes in the provinces. If they catch on, Mr Putin will have to decide whether to crack down or back down and risk fuelling inflation.

Collecting foreign stamps

The biggest puzzle is who makes policy towards the rest of the world. The foreign ministry these days provides little more than a delivery service for other people's messages. A bunch of competent English-speaking conference-warriors from Moscow think-tanks puts a gloss on the Kremlin's thinking for the benefit of international audiences, but none seems really close to Mr Putin. The Kremlin's own foreign-policy team is more concerned with protocol and logistics than policy planning. A wily pal or two from Mr Putin's old employer, the foreign intelligence service, may bend his ear. But he seems to have thought up his new pro-western policy mainly off his own bat.

As a result, Mr Putin looks quite lonely on this front. He may have his best chats on foreign affairs with other world leaders, such as Germany's Gerhard Schröder. Pollsters suggest that most Russians prefer being friends with the West than with Russia's dodgier pals of the past, but powerful lobbies argue otherwise. The oil companies want business with Iraq; the nuclear industry has old ties with Iran; and the arms exporters have a lucrative deal to sell missile systems and much else to China.

Mr Putin's cleverest tactic at home has been to distance himself from day-to-day politics. His public forays this year have been into uncontroversial subjects such as child welfare, sport and crime. Wise were the monarchs who kept away from politics. But can Tsar Vladimir manage that?

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Charlemagne

Zoran Djindjic and Balkan maps

Feb 14th 2002
From The Economist print edition

Serbia's prime minister is bravely thinking about a humbler kind of country

IN THE coming months, the world will hear a lot about a plan to expand the borders of one European country and ensure its absolute domination by a single ethnic group. The prosecutors of Slobodan Milosevic, the former Yugoslav president whose trial began this week in The Hague, will argue that he was the main advocate of a Greater Serbia that would engulf hunks of neighbouring Bosnia and Croatia. To most people in the West, the implications of such a project, even if the methods had been less brutal, are patently sinister, recalling the Nazis' dream of gathering all German-speakers into a single racially pure Reich.

Indeed, all talk of territorially-defined greatness is repulsive to most West Europeans, particularly to politically-conscious Germans: it runs counter to the assumptions that have underpinned politics in the continent's non-communist half since 1945. Didn't the second world war quash forever the idea that a European country could be deemed successful by bolstering itself with land grabs or by ethnic discrimination?

In fact, a pollster using crafty questions might well find that people in Europe's south-eastern corner, not all them Serb nationalists, are still ambivalent on such matters. After all, territorial conquest and ethnic engineering helped form the Balkans' modern states in the wars of the late 19th and early 20th century, and western powers then seemed happy to egg their various proxies on. Many Balkan historians, not all of them admirers of Mr Milosevic, detect a whiff of hypocrisy in the disdain which people in settled and prosperous parts of Europe now accord to old-fashioned nationalism. They remember, for one thing, the romantic patriotism of those who unified Germany in the 19th century. So if Mr Milosevic had been around a few generations earlier, he would probably have found it easier to win foreign backers for his Greater Serbia project. His biggest mistake was his failure to realise what era he was living in.

What a pleasant surprise, then, to find that his successor as the most powerful man in Belgrade is uncompromisingly modern, in language and demeanour. Zoran Djindjic, a philosophy teacher with a razor-sharp mind and an oft-stated preference for what he calls “hard reality” over lofty ideals, has been Serbia's prime minister for just over a year. He is more influential though less popular than Vojislav Kostunica, the Yugoslav president who presides over the malfunctioning federation between Serbia and its disaffected little partner, Montenegro.

An army officer's son, Mr Djindjic spent his formative years studying in Germany, where he became an admirer of Jürgen Habermas, a philosopher who laid bare the myths of 19th-century nationalism and has called more recently for a European constitution. The Serbian leader's style, from his designer suits to the clipped tones of his newly-acquired English, is full of reminders of his close ties with the German academic establishment at its most enlightened and politically correct.

While Mr Milosevic went out of his way to provoke the world, Mr Djindjic is hyper-conscious of international opinion. He is proudest, to date, of having restored Yugoslavia's relations with the Paris Club of government creditors. While Serbs grumble over soaring utility bills, he basks in the EU's praise for his economic reforms. His promise to continue “co-operation” with the war-crimes tribunal at The Hague, meaning that he will extradite more Serbs there when asked, is ruthlessly pragmatic. The fate of a handful of people, he reckons, should not compromise the welfare of millions of Serbs, who will suffer unless their country is fully re-integrated into Europe.

While Mr Milosevic appealed to nationalist sentimentality, Mr Djindjic is rigorously unsentimental. Unlike many Serbs, he is not especially concerned about “losing” Montenegro, where President Milo Djukanovic has promised a referendum on independence as early as April. If Montenegro broke away, Mr Djindjic

says, it might harm itself by ignoring its EU friends' advice. But that would not stop Serbia from forging ahead with reform.

Mr Djindjic rightly says that the EU loathes the thought of Montenegro's independence. Spurring the statelet on towards at least autonomy while Mr Milosevic was in power seemed a sensible way to undermine him. But now that power in Belgrade is in benign hands, the West has little desire to see yet another Balkan state emerge, especially one whose independence would be supported, at best, by only slightly more than half its people.

Finding the right place in Europe

Another argument against Montenegrin independence is often heard in Brussels. The UN resolution that ended the Kosovo war in mid-1999 called it part of Yugoslavia, not of Serbia. If Yugoslavia ceased to exist, Kosovo's ethnic Albanians would demand immediate independence. This final break-up of rump Yugoslavia, so the argument goes, might then tear Macedonia apart. And if that happened, would Bosnia hold together?

Mr Djindjic sees some force in these arguments but insists that whatever happens in Montenegro would not inevitably trigger more war. And he disagrees with those who say that Kosovo's status should stay ambiguous indefinitely. That does not appeal to Mr Djindjic's tidy Teutonic mind. He wants Kosovo's future resolved within two or three years. His government, he says, should start by telling Serbs the hard truth that well over 1.5m people there are irreconcilably against being ruled from Belgrade. A debate about what to do should then ensue.

No Serbian politician, not even Mr Djindjic, could ever call for Kosovo's independence tomorrow. But he does say, more boldly than most Serbs, that “all options” should be considered, with due regard for the overriding aim of getting all of the Balkans one day into the EU. “We must find a solution mainly by finding our place in Europe, not by seeking historical rights or national interests.” This new Serbian leader talks the language of Germany in the 21st century, not the 19th or any other.

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Misspent youth

The naughty boy of Europe

Feb 14th 2002
From The Economist print edition

Everynight Images

Britain's unruly teenagers are the price of progress

READERS of British newspapers have, in the past week, been scandalised by the claims of several teenage boys to have had sex with their teacher at drunken parties. They have gawked at the unruliness of a teenage witness in the trial of four youths accused of murdering a ten-year-old. In other news, prolific juvenile mobile-phone bandits manage to skew the nation's violent crime figures. If generalisations were not so perilous, it would be tempting to infer that there is something peculiarly delinquent about British youth.

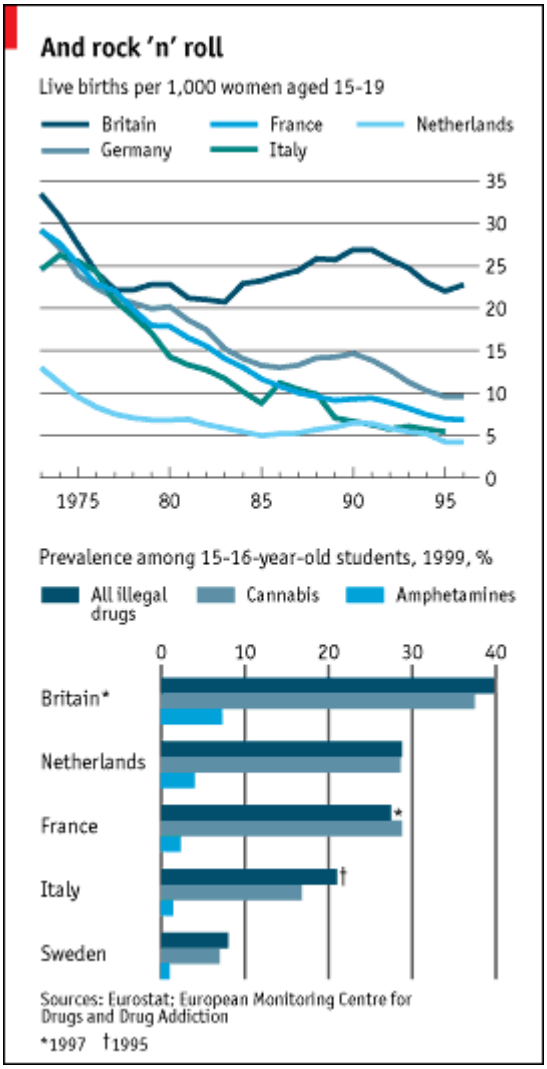
In fact, there is. On just about any measure of naughtiness, British teenagers are worse behaved than others in Europe (see charts). Among their other distinctions, they take drugs more than their counterparts, and only Danish youngsters booze as much. Teenage girls in Britain are more likely to give birth than any others in Western Europe (although American girls are even more fecund). A higher proportion of robbery convictions are made against under 18s in England and Wales than anywhere else in Europe. And so on.

Of course, old fogies have always worried about young tearaways, especially in Britain: where other nations regard youth as a resource, Britain has tended to perceive it as a problem. The shepherd in Shakespeare's “The Winter's Tale”, for example, wishes that there were no such age as that between ten and 23, which is spent “getting wenches with child, wronging the ancientry, stealing [and] fighting”.

But it wasn't ever quite thus. In the past decade, school exclusions and the incidence of sexually transmitted diseases among teenagers have rocketed. The proportion of 14-17-year-old boys admitting to breaking the law rose by 14% between 1993 and 1999; girls are increasingly sharing the fun of violent crime. Young men are not growing out of property crime as early as they once did. And they do more harm to themselves, as well as to others: the suicide rate among British males aged 15 to 24 has more than doubled over 30 years.

Some of these problems can be solved by simply thinking about them in a more grown-up way. Under-age drinking and cannabis smoking, for instance, although they can cause some health problems, are generally fairly harmless, even if they are illegal. The much-cited teen pregnancy statistics do not really denote a plague of promiscuity: more British teenagers got pregnant 30 years ago, though then they tended to be (or get) married, so were less likely to become a burden to the taxpayer. Nevertheless, teenage delinquency is definitely costly, not least because it tends to anticipate similar problems in later life, and to be inherited by the delinquents' own children.

Two schismatic social developments are routinely cited to explain the malaise. One is economic. The decline of British industry has meant that poorly educated men, in particular, have fewer job opportunities. More children grow up in workless households in Britain than in any other rich country. The flaw in this explanation is that British teenagers are, in general, richer, better educated and wealthier than ever. Drinking and drug-taking require disposable incomes; many of these problems affect the entire social scale (witness the travails of Prince Harry, the third in line to the throne, whose drinking and dope-smoking has spread joy among newspaper editors).



Blame the parents

The other explanation emphasises the growth of divorce, single parenthood (the number of children who live with only one parent has trebled in 30 years), and what used to be called illegitimacy. This argument tends also to drag in the decline of educational standards and the emasculation wrought by feminism. Another sort of familial explanation cites the long hours absentee British parents work.

Because familial instability and poverty often accompany each other, it is difficult to say which exerts a greater influence on teenagers' behaviour. But one way in which the government can definitely make a difference is to keep more children in school: fewer British children stay in education beyond the age of 16 than in most comparable countries, and more leave school with few or no qualifications than in any other EU country except Portugal. Educational reforms announced this week are designed to do precisely that.

A less gloomy interpretation is that the angst some teenagers experience and cause is the side effect of two otherwise desirable trends. A minority may be getting too little education, but most are getting more than their parents did, and in consequence entering the labour market and assuming adult responsibilities later. During this prolonged adolescence, British youngsters tend to get less support from their families than do others. Juvenility may persist longer than it previously did.

The other happy trend is the slow dissolution of the class system. Young people no longer follow predestined paths. Social superiors and authority figures who once commanded automatic deference now have to earn it—another good thing, unless you are an old woman on an inner-city estate or a teacher in a sink school.

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Mercenaries

Mad Mike comes in from the cold

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Why is the government planning to regulate mercenaries?

ONE of the most controversial matters in international relations over the past few decades has been the steady rise in the use of mercenaries and “private security” companies. Britain, with plenty of ex-soldiers to draw on, looms large in this business, but does not tend to boast much of its prowess. Colonel “Mad” Mike Hoare, an ex-paratrooper, entered popular culture as a byword for mayhem for his exploits in the Congo and South Africa in the mid-1970s. He and his men were eventually picked up trying to topple the government of the Seychelles in 1981, having infiltrated the islands disguised as a visiting beer-tasting team, the “Ancient Order of Frothblowers”.

Successive British governments have kept the mercenaries at arm's length. Now, however, the foreign secretary, Jack Straw, has decided that mercenaries are, in fact, rather a good thing. They have therefore, in true New Labour fashion, been re-branded as “private military companies” (PMCs). And this week the Foreign Office published a Green Paper proposing a system of licensing or regulation for companies offering military services abroad.

Not surprisingly, this has prompted outrage amongst some of the government's own back-benchers. After all, this new policy hardly seems to fit very well with Labour's “ethical foreign policy”. So what is the government up to?

Mr Straw claims that in the post-cold war world of “small wars and weak states”, there is now a legitimate role for PMCs. For a state under threat from “armed insurgents” or from “criminal gangs”, the swift intervention of a PMC might be the only “realistic” option. By contrast, national governments or, even worse, the UN, can take weeks or months to mobilise public opinion and put a force together. By then the “peacekeepers” are usually picking bodies out of the swamp.

This re-think about mercenaries was prompted by just such a situation in Sierra Leone in the late 1990s. A London-based PMC, Sandline, was used to return the ousted president to power after a military takeover. Sandline claimed that it had acted with Foreign Office approval, despite breaking a UN arms embargo. The operation was successful, British troops followed in the footsteps of Sandline, and Tony Blair was recently hailed as a saviour in the country.

The suspicion is that these proposals are for the benefit not so much of foreign governments as of the British government. Mr Blair has grand ambitions for more intervention abroad, especially in Africa, but Britain's regular armed forces are overstretched. Anyway, the British public does not like to see British soldiers dying in other people's fights, but it does not care what happens to mercenaries.

These proposals may be a move towards sanctioning the overt government use of PMCs abroad. Regulating PMCs and making them conform to a “code of conduct” on human rights might make such operations somewhat more acceptable to a sceptical public. No doubt the regulator will be known as Ofkill.

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London's crime wave

Arise, Sir Rudy

Feb 14th 2002
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New York's ex-mayor does not have a quick fix for London crime

FOR Londoners in a panic over crime, the arrival of New York's former mayor, Rudolph Giuliani, this week, could not have been better timed. Sir Rudy, in London to receive an honorary knighthood, received his gong as much for his record in cleaning up his city as for his inspirational leadership after September 11th. Tony Blair, the prime minister, David Blunkett, the home secretary, and anybody who could get to him was queuing up to hear how he managed to reduce crime by more than half while in office.

Murder aside, London's crime rate is far higher than New York's, and rising (see chart). Street crime has increased by more than a third over the past nine months. Muggings are up by 26%, thanks to an epidemic of mobile-phone thefts and bag snatching. As less than half of robberies are reported to the police, the real number of victims of street crime in London could well exceed 100,000 this year. If only, say Londoners, the Met would adopt the "zero tolerance" approach that New York's finest took to beggars, graffiti artists, prostitutes, casual drug users and other shady street characters, then surely the problem could be solved.

It's not as simple as that. For a start, London is one of the most thinly-policed cities in the western world. New York, which has a similar population, has more than 50,000 officers, nearly twice as many as London and four times as many per square mile. Each London bobby has to deal with an average of 41 crimes, six times as many as New York's finest.

Like all success stories, Mr Giuliani's achievement in reducing crime, aided by two able police commissioners, William Bratton and Howard Safir, is surrounded by myth. But the truth, inevitably, was duller and subtler than the legend. New York's crime was reduced more by targeting and making the police accountable to their bosses than by making life miserable for squeegee merchants.

Holding individual precinct commanders responsible for what took place on their patch was crucial. Detailed computerised analyses of crime, reviewed every morning in police headquarters, made this possible. The "compstats" threw up, for example, the fact that 28% of the police in Queens had not produced an arrest in six months. New York also used the civil law to close down notorious crack dens and brothels. A similar targeted approach could pay dividends in London.

There is obviously a danger in placing too much emphasis on crime statistics. Pressure for results can easily lead to falsification. But better information does at least give police bosses a handle on what's going on in their city.

There is no zero-tolerance quick-fix for London's crime. Spending lots of money on police and computers would help.

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Justice

The wrong man

Feb 14th 2002
From The Economist print edition

Locking up the usual suspects is no way to fight terrorism

Reuters

Raissi and wife, vindicated

LOTFI RAISSI, a 27-year-old Algerian pilot, admits he is no angel. He has a conviction for theft and has acknowledged using a false identity card. But Mr Raissi, who has been in Belmarsh high-security jail since his arrest on terrorism charges last September, has, along with his French wife and his family, loudly protested his innocence. He now seems to have been vindicated.

On February 12th, Mr Raissi was freed on bail after lawyers representing the American government finally admitted that they had no evidence to support the claim that he was the lead instructor for the pilot who flew American Airlines flight 77 into the Pentagon on September 11th. The only charges now remaining against Mr Raissi are that he failed to declare either an old knee injury or his teenage conviction for theft on an application for an American pilot's licence. These charges are so minor that they are unlikely to lead to extradition. It looks rather as if they are being pursued only because it would be too embarrassing to drop them now.

When Mr Raissi appeared at Bow Street magistrates court in London at the end of September, the government's lawyers claimed that the FBI had evidence to show not just association with the suicide pilots but also evidence of “active conspiracy-proving correspondence and telecommunications”.

All the supposed evidence to substantiate this charge has crumbled. A key part of the case against Mr Raissi was the FBI's claim that it had video footage of him with Hani Hanjour, the pilot of the doomed plane. This turned out to consist of poor quality web-cam images of Mr Raissi with his cousin in his own flat. The FBI further claimed that Mr Raissi and Mr Hanjour had trained on the same aircraft. But, like the frequent telephone calls that are alleged to have taken place between the two men, no evidence for this has been produced that would stand up in court.

Mr Raissi's case raises several disturbing issues. Should a suspect be locked up in a high-security prison for more than five months to allow the FBI to try to substantiate its claims? Was the Crown Prosecution Service pressured into pursuing a case that was at best circumstantial? Finally, why did the courts take so long before deciding that Mr Raissi had no case to answer when intelligence officers on both sides of the Atlantic acknowledged privately that the evidence against him was tenuous? The pressures on both the British and American law enforcement agencies after the September 11th attacks were enormous. But that cannot provide an excuse for locking up “the usual suspects”, for five months.

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Energy policy

New nukes or wind farms?

Feb 14th 2002
From The Economist print edition

Britain cannot go green without paying a price

HOW do you cut emissions of greenhouse gases (GHGs) while ensuring that voters still get cheap electricity? After wrestling with this question for months, the government this week pretty much admitted that it cannot be done.

A long-awaited report published on February 14th by Tony Blair's performance and innovation unit (PIU), part of the Cabinet Office, was supposed to set out the broad outlines of energy policy for the next 50 years. Actually, all the report does is to invite a debate on whether there should be such a policy, or whether things should be left mostly to market forces.

Classical energy policy suggests that countries need a range of power sources—coal, nuclear, gas and so on—with as much as possible coming from domestic supplies. The rationale is to ensure there are alternatives even if one source is disrupted or if international events interrupt imports, but it means government spending heavily on meddling in the marketplace.

Increasingly, liberalised markets are seen as the best guarantor of energy security. The remarkable resilience of Britain's electricity trading system recently, despite the collapse of Enron, the country's biggest energy trader, bolsters this argument. What's more, liberalisation has given Britain the cheapest energy in Europe.

Mr Blair's government has avoided making tough decisions about energy policy. That has been possible because it inherited plenty of nuclear power and offshore gas. Just over 40% of electricity is produced by gas, just under 30% by coal, 25% by nuclear and tiny amounts from oil and renewables.

Two factors will bring about difficult choices. First is Britain's noisy commitment to the Kyoto protocol, a UN treaty to combat global warming. Mr Blair even dared to criticise his bosom buddy, George Bush, for walking out on Kyoto last year. That pact commits Britain to sharp cuts in its emissions of GHGs. Second, nine of Britain's ten nuclear power stations are due to shut down by 2025. Nuclear plants produce no GHGs. Unless those plants are replaced by carbon-free sources (new nukes or renewables), Britain's climate goals cannot be met.

The government wants a big expansion of renewable energy, from supplying 3% of electricity needs now to 20% in 2020. Experts agree it is possible. A recent report for the Scottish government reckoned that there is enough potential wind and wave power around Scottish coasts to supply 75% of Britain's electricity needs.

But how to get there? British Energy, a nuclear generator, and AMEC, a big construction firm, are looking at building a 300-turbine wind farm, the biggest yet in Europe, on the Hebridean island of Lewis. It would generate about 600MW, about half the output of a nuclear power station. But British Energy thinks it may need a subsidy to help pay for the £300m-400m cost of laying a sub-sea cable to get to the main electricity market in England. Supplying this sort of power on the scale envisaged would, the government reckons, raise electricity bills by up to 6%.

The PIU also wants to keep the nuclear option open, but public opinion is hostile. Even if that can be overcome, British Energy admits that current electricity prices are too low for new nuclear to be

economic; it needs fresh subsidies too.

The PIU report is not keen on that, preferring to wait and see if new technologies bring the cost of nuclear power down. Even if that happens, few banks are willing to finance such a project unless the costs of dealing with nuclear waste and insuring against accidents are sorted out. These costs too, are likely to fall on the taxpayer or the consumer. Renewable or nuclear, greenery will be costly.

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The economy

Rebalancing act

Feb 14th 2002
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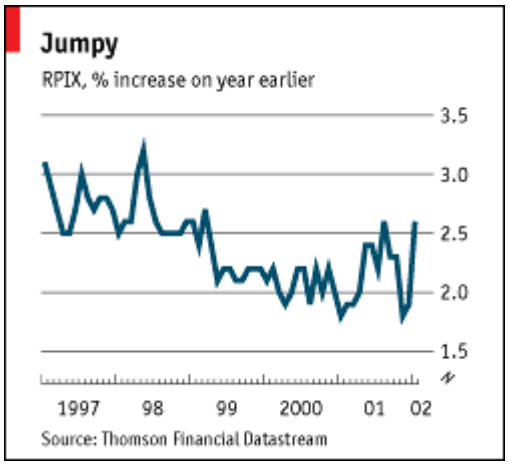
The Bank of England is likely to raise interest rates sooner than expected

FOR the consumer, it has been the best of times, for the manufacturer the worst of times. Not since 1981 has there been a greater disparity between the fortunes of export-reliant manufacturers and the domestically-oriented services sector. Britain is outstripping other big economies, but at the cost of worrying imbalances, most notably a remarkable consumer boom.

This contributed to a sudden jump in inflation from 1.9% in the year to December to 2.6% in January—the biggest increase in more than ten years, taking it above the 2.5% target for the first time since August. Some of this was expected because fuel prices rose a bit in January whereas they fell a year before. But the rise in inflation also reflected more broadly based pressures stoked up by the house-price boom and buoyant spending on the high street. Inflation in the services component of the retail price index rose from 4.1% to 4.6%, the highest since June 1993.



According to the Bank's quarterly *Inflation Report*, issued this week, the risks to the inflation outlook will shift away from under-shooting the target towards over-shooting it over the next two years. Its central projection is that inflation will be a little under 2.5% in two years' time. However, the Bank estimates there is a one-in-five chance that it may exceed 3.5% by the start of 2004, which would trigger an explanatory letter to Gordon Brown.

The Bank's main worry is of a much sharper decline in the pound than the modest decline that it has factored in to its forecast. This would raise import prices and so feed through to higher inflation. The most likely cause of such a decline would be an early referendum on joining the euro as foreign exchange dealers bet on a lower conversion rate for the pound. However, Mervyn King, the Bank's deputy governor, denied this week that the Bank had this scenario in mind when preparing its outlook for inflation.

The Bank completed its forecast before learning of the jump in inflation; although its Monetary Policy Committee did get advance warning of the rise at its meeting on February 7th, when it decided to leave the repo rate on hold at 4%. It will now want to feed this and two other new figures into its forecasting machine. After rising for three months, the number of people claiming unemployment benefit fell unexpectedly by 10,600 in January, suggesting that the labour market remains tight. On the other hand, the annual growth in average earnings subsided from 4.1% to 3.3% because of lower bonus payments.

The overall picture is one of an economy that urgently needs to be rebalanced as soon as a world economic recovery permits. Indeed, Mr King said that an orderly unwinding of the imbalances in the economy was “the major policy challenge over the next two to three years”. The Bank hopes that much of this will occur of its own accord. Consumer spending should respond to lower increases in real income and declines in stockmarket wealth by decelerating to more realistic rates of growth. Exports and manufacturing should gradually revive as the world economy recovers.

But it is also clear that the Bank will have to do some of the adjusting itself. After all, one of the main reasons why consumer spending has been so buoyant is that it cut interest rates by two percentage points last year. Following the surprise rise in inflation, the financial markets are pricing in an earlier increase in interest rates. They now expect the Bank to start raising the repo rate in the spring and for it

to reach 5% by the end of the year.

It was a fine party while it lasted—and it has lasted a long time. But the Bank is preparing to bring the consumer spending boom to an end.

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Education

Don't mention the V-word

Feb 14th 2002
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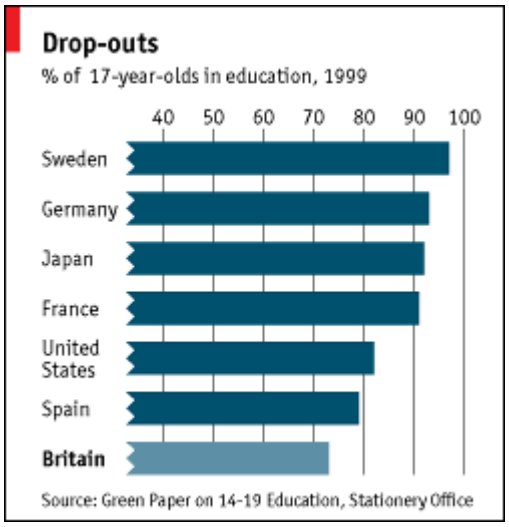
Proposals to reform 14+ education will not fill the skills gap

EVERY Monday morning for the past year, a plane-load of engineers has flown into Birmingham from Germany. They spend the week at BMW's plant at Oxford, working on the new Mini. On Friday, they fly back to Germany.

This solution to Britain's chronic skill shortage may work for BMW, but it isn't an answer for the economy as a whole. The government hopes that the latest radical overhaul of the education system, announced on February 12th, may be. The reforms are also intended to improve Britain's poor record on educational drop-outs at the age of 16 (see chart).



The government reckons that the rot sets in for many pupils when they are around 14, because GCSE exams, academic rather than practical in nature, turn them off education altogether. They play truant, and thus, in effect, stop being educated long before the formal end of schooling when they reach 16.

To tackle this problem, Estelle Morris, the education secretary, has announced a new tranche of courses for 14-year-olds, which can be taken alongside GCSEs. These new hybrid courses will be in more practical subjects, such as engineering, leisure and tourism, and social care. These would then join up with vocational A-levels to constitute a new educational “spine” from 14 to 19. And how will Ms Morris overturn the “snobbery” that she feels attaches to these vocational courses? By abolishing the word vocational, of course.

In order to make room for the new courses, 14-year-olds will no longer be required to learn modern languages. Language teaching will now start in primary schools, when pupils are seven years old.

There are worries that these proposals represent more dumbing down of education. In engineering, for instance, there are not enough qualified pupils to take up university places. The government thinks the new hybrid engineering course for 14-year-olds will help rectify the problem. But this may just deflect pupils from struggling to pass their physics GCSE. Without that, they cannot go on to do the physics A-level which is a prerequisite for a university place. More may mean less.

Employers also argue that the most important problem, and the one that divides Britain most shamingly from the rest of Europe, is poor numeracy and literacy. The new proposals do not address the problem of basic skills. And, more strangely still for a government so enthusiastic about skills, there is almost no mention of apprenticeship. In Germany, about 65% of young people obtain an apprenticeship certificate, whereas in Britain the figure is less than 20%. A new report on apprenticeship by Hilary Steedman of the London School of Economics concludes that “apprenticeship in Britain, judged as a programme, falls short of that provided elsewhere in Europe on every important measure of good practice.”

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Bagehot

Pop idols

Feb 14th 2002
From The Economist print edition

How not to make politics interesting again

HE WHO is tired of London is tired of life. He who is tired of politics may be tired of life or may just care rather more about other things. For reasons of self-interest and self-importance, this thought does not seem to have occurred either to Britain's politicians or to the broadcasting panjandrums who are responsible for the BBC's political programmes. Both of these attention-seeking castes are in a panic about the dwindling public appetite for their wares. And they are having a strangely circular argument about who is to blame for it.

The argument goes something like this. The politicians say that citizens are being turned off politics by the cynicism of the media. Whereupon the BBC looks into ways of making its political coverage more appealing. Whereupon the politicians warn the BBC, whose purse-strings they control, not to “dumb down” its programmes. Whereupon the BBC grumbles, *sotto voce*, that the politicians have only themselves to blame for making politics a turn-off. In Britain, goes the grumble, politicians have pulled off the impressive feat of making politics look cynical, boring, dumbed-down and irrelevant—all at the same time.

What started the panic among MPs and broadcasters was last June's general election, an eminently forgettable affair that delivered only two surprises. One was that the Labour Party won by an even wider margin than everyone had expected it to. The other is that even fewer people bothered to vote than had been expected to. To be exact, only six out of ten eligible voters turned out. The electoral commission, a new body set up (under a former BBC journalist) to think about such things, frets that “Pop Idol”, a phone-in-your-vote TV talent show, scooped in more votes than the number cast in the general election. The young, it seems, are especially guilty of caring more about the relative talents of “Pop Idol” wannabes such as Will and Gareth than prime-ministerial wannabes such as Charles Kennedy and Iain Duncan Smith. Fewer than four out of ten Britons between 18 and 24 voted in the general election. And when political programmes start on TV, they switch off in droves.

Shock? Horror? A crisis for representative democracy? So you would think if you heeded the hysterical reaction of the politicians. They too, remember, are in a branch of the entertainment business. But unlike pop idols they are losing market share, and are desperate to avoid losing any more. So Robin Cook, leader of the Commons, reminds the BBC from the floor of the House of its duty as a public service with public money to cover Parliament “properly”. Charles Clarke and David Davis, the chairmen of the Labour and Conservative Parties, have sent the BBC a joint letter of concern. The Corporation's plea that it has no plan to cut or dumb down its coverage of politics, only to make what it shows more interesting, has not soothed them. Mr Clarke was on the rampage again this week, castigating journalists for showing MPs too little respect and “promoting cynicism”.

Bagehot respectfully differs—from all of the above. That is to say, the low turnout last June does not betoken a crisis of democracy. Far from being boring, British politics fascinates its devotees, even if, like opera buffs, they are often small in number. As with opera, no amount of trendy revamping is likely to broaden the appeal of politics very far. As for cynicism, this needs no promotion by journalists: the government has been doing a perfectly adequate job of promoting it on its own.

Spot the difference

The turnout in the last election was indeed unusually low, but not for any grave or mysterious reason. The result was a foregone conclusion, the Tories failed to present themselves as a viable opposition and on policy there was not much to choose between the parties. New data from the British Social Attitudes

survey, published by the National Centre for Social Research, confirms that voters saw things this way. Last June a mere 16% of voters thought that there was a great deal of difference between Labour and the Tories. In no other election since 1964 has this proportion dipped below a third. A democracy in which the parties broadly agree about what needs to be done is hardly “in crisis”, even if this makes for duller elections. So the young are turned off? They'll vote when they grow up.

The claim that politics has become boring in some way that could be disguised by cleverer presentation is equally tendentious. Britain's policy dilemmas—how to change the welfare state, when or if to join the euro, whether to ban foxhunting—are not intrinsically boring. According to Social Attitudes, 31% of voters expressed a great deal or quite a lot of interest in politics last June, more than in 1997, when Labour stormed back and ended 18 years of Conservative rule. If politics feels less passionate, that is because the parties no longer inspire partisanship. Nearly two out of three voters say that they feel little or no emotional attachment to any of them. This may or may not be a good thing, but it is not the job of the BBC to whip up the old tribalism, even if it could. If audiences decline, so what? One of the better arguments for public-service broadcasting is that it delivers very worthy programmes to very small audiences.

Politicians are on firmer ground when they complain of cynicism. The Social Attitudes survey confirms that voters are more cynical than ever about politicians. But why blame the media? Labour made a meal of Tory “sleaze” in opposition, and is tasting its own medicine in government. In all the cases that have plagued it—the controversial donation from Bernie Ecclestone; the resignations of sundry ministers; the suspension from the Commons of one of those ministers, Keith Vaz; Enron; and the developing argument over whether the prime minister should have promoted a commercial deal in Romania for Lakshmi Mittal, an Indian businessman and Labour donor—opposition politicians have demanded inquiries and explanations. The journos have just dug out the facts. How shockingly old-fashioned.

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Time to grow up

Feb 14th 2002
From The Economist print edition

Rex

Pension systems in rich countries are not working properly. They need a radical overhaul, argues Paul Wallace

IMAGINE a world where you had no direct property right to your most important financial asset, probably worth more than your house; where the value of that asset bore no direct relationship to what you had put into it; and where that asset, and the return on it, was often assigned to you arbitrarily and unfairly.

In fact you don't have to do much imagining at all: the peculiar world of pensions is all around us. To take one example, in America the value of future public-pension payments for a typical household headed by a 65-year-old man is $180,000; but this is not a legally enforceable claim to ownership, as a Supreme Court ruling made clear in 1960. Not that the post-war generations of pensioners in the developed world have been much bothered by such legal niceties. After all, many of them have seen a spectacular return on their contributions, receiving far more in benefits than their due.

One way of thinking about public pensions is as a form of insurance for which you pay premiums while you are working, against the predictable risk of a period without earnings later in life. Such a system of insurance, you would expect, would convert your contributions, together with the interest they earn, into pension benefits in an actuarially fair way. When you retired, your pension would reflect the contributions you had made, plus interest, and the length of time you were likely to spend in retirement, except that a small amount would be deducted to provide a minimum-income guarantee for those who, through illness or misfortune, had been unable to build up enough contributions of their own.

Again, real-life pensions fail to pass this test. Public pension systems do not achieve a reasonable trade-off between actuarial fairness and protection against poverty in old age. What they mainly do is redistribute income from the young (who may be poor) to the old (who may be rich), often in an inequitable way.

Nor do pensions provided by companies come off much better. “Final-salary” schemes, until recently the most common form of private pension, are often just as actuarially unfair as public pensions. Early leavers lose out, whereas time-servers and top managers do disproportionately well.

Pension systems that work so capriciously make little sense at the best of times, and even less in an ageing world. Populations in the West and Japan are no longer pyramid-shaped as they used to be, with a big base of younger people and few pensioners at the top. Instead they are becoming top-heavy, with many more older people both in the workforce and in retirement. Ill-designed pension systems magnify the effect of population ageing by creating incentives for people to retire ever earlier. Unaffordable public-pension commitments threaten the fiscal solvency of many countries in the European Union.

Some people even see pensions as a national security issue, arguing they are set to gobble up so much public money that they may crowd out defence spending. Richard Parsons, the co-chairman of the president's commission on reforming pensions in America, pointed out last November that his country had been able to mount an effective response to the terrorist attacks of September 11th because it could afford a military arsenal, thanks to its strong balance-sheet. But, he added, “30 years from now, if we do not do something to fix the Social-Security system, we are not going to have a strong balance-sheet.” Paul Hewitt, an analyst at the Centre for Strategic and International Studies in Washington, DC, claims that “our pension systems are a strategic liability”.

State pensions were established when old age spelt poverty for most people, to which they offered a collective and paternalistic solution in the form of a pay-as-you-go (PAYG) pension system. Such systems tax the income of workers and transfer it to pensioners. They rest on an implied but unenforceable contract between generations: the future pensions of those working today depend upon a future generation of workers. The pensions are paid as defined benefits (DB), which means they are not expressly linked to what workers have paid in contributions. Instead, pensioners get a defined level of income, usually related to average pay.

Company pensions, unlike public PAYG systems, are backed by funds or assets. Where they pay out defined benefits, as in final-salary schemes, they too are essentially paternalistic. Employees get pensions that replace their final working incomes at a rate reflecting the time they have spent in the company. The company shoulders the risk that investment returns may disappoint, or that its pensioners might live longer than expected.

But whatever their virtues in the past, both final-salary pension and PAYG schemes are inappropriate for today's ageing populations in the West and Japan. Pensions need to grow up, which will require radical changes in their architecture (see article).

The shape of things to come

Governments and companies recognise this, and have embarked on various reforms. First, most countries are shifting their pension systems away from PAYG towards funding, thus ensuring that a larger proportion of pensions is paid from savings that have been invested in financial assets. Such investments can be built up either in a public reserve fund or in privately held individual retirement accounts.

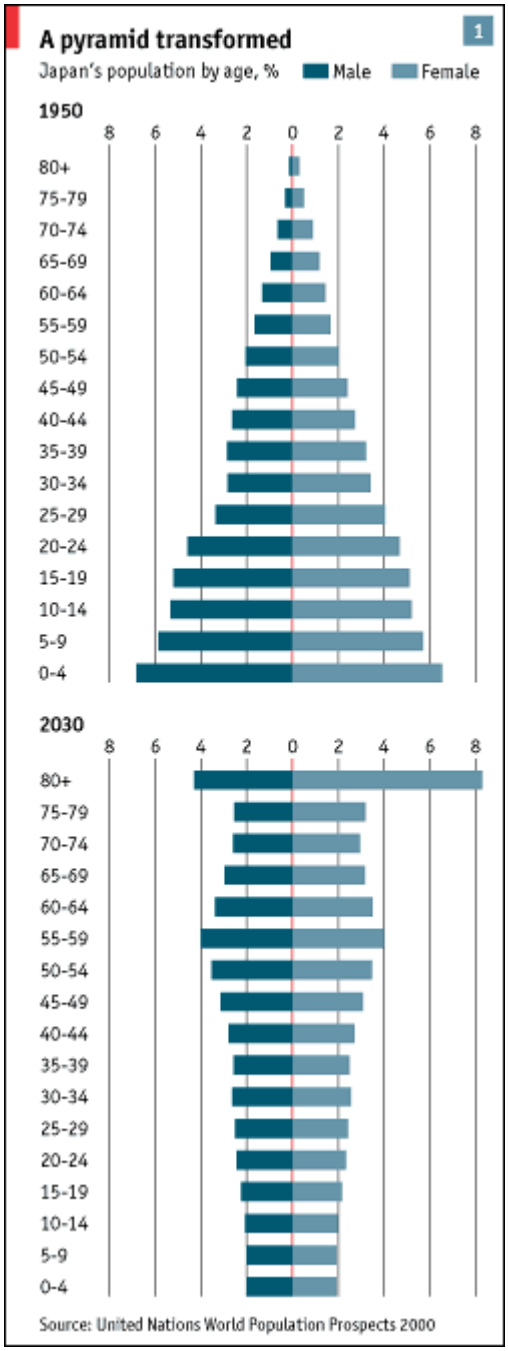
Second, pension regimes that offer defined benefits are giving way to the sort that link payments to contributions. With defined contributions (DC), the link between what people put in and what they get out is made explicit. There is no promise of any particular level of benefits. Individuals themselves have to ensure that they build up enough assets to provide an adequate retirement income. With that responsibility comes the right of ownership to pensions.

These reforms are transforming both state and company pensions, with their welfarist and paternalist origins, into regimes that allow people to take charge of their own retirement provision. This should be for the good. Allowing individuals to plan for their own retirement will allow them to strike the right balance between saving while they are working and drawing down their funds in retirement. Yet it also means that many more people will face new forms of risk, particularly investment risk, which the bear market of the past two years has highlighted.

Here, too, there is a need to grow up. The long bull market of the 1980s and 1990s persuaded many people that pension capital can be built up with little sacrifice. Not so: it takes a lot of hard saving. Buoyant financial markets also encouraged the fond belief that a shift from a PAYG to a funded system will be easy. Not so again: it involves real losses to people. One of the main arguments for reform now is to get younger generations started on building alternative funding streams.

Yet despite these caveats, this survey will argue that incurring the

costs of switching to a different system and shouldering new kinds of risk is less hazardous than carrying on as before. The traditional pension regime has two main faults: it ties state pensions to the decisions of future politicians (and the electorates that vote them into power), and it creates incentives that favour early retirement and discourage job mobility. Reform may be painful, but it is the only way out of the pension trap in which so many western countries now find themselves.



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P is for perfect

Feb 14th 2002
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A guide for pension designers

THE architecture of pension systems matters. Reformers need to consider all the following components:

• **Provider**. In principle this could be the state or the private sector, but generally both provide pensions, forming what are sometimes called the first and second pillars. The extent of private provision varies markedly. In continental Europe the public pillar bears most of the weight, whereas in America and Britain the private pillar takes a lot of the load. In Latin America, private provision has become widespread.

• **Choice**. Membership of a pension plan can be mandatory or voluntary. State systems are generally mandatory, but can have a voluntary component, as has been proposed for America's Social-Security (public-pension) system. Governments can also oblige their citizens to hold private accounts, as they do in Australia and Sweden. And many countries encourage private voluntary plans for retirement saving, often described as the pension system's third pillar.

• **Function**. A pension system has two main objectives: relief of poverty in old age, which is a form of income redistribution; and ensuring that most pensioners can provide for themselves in retirement. The state has an interest in both. It will want to deliver the first itself, and will want to be certain that the second is being met. Where the private sector is responsible for the second task, the government will want to make sure that the coverage is adequate.

• **Structure**. There are two main kinds of pension. “Defined benefit” (DB) plans promise members a set portion of their working income in retirement. “Defined contribution” (DC) plans pay out in pensions what members have contributed, plus investment returns.

• **Financing**. Most countries rely mainly on public pay-as-you-go pensions. With PAYG, today's pensions are paid from contributions made by today's workers, who in turn hope that their pensions will be paid for by tomorrow's workers. The main alternative is for workers to save to build up their own pot of assets. The part that state pensions play in relieving poverty in old age is best financed through general taxation.

• **Internal and external funding**. The assets built up to back funded pensions can be held either internally or in a fund that invests externally. For public pensions that are partially funded, what matters is the overall effect on net public debt. For private pensions, the main contrast is between company plans that are internally financed through “book reserves”, ie, off the company's own balance-sheet; or in a separate pension fund that invests in financial assets.

• **History**. This is often the most important influence of all. In developed economies, policymakers do not have the luxury of starting from scratch. They are constrained by existing designs, notably PAYG schemes that have paid out much more to previous and current generations of pensioners than they paid into them. This creates an overhang of debt that reduces future returns to today's workers.

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Snares and delusions

Feb 14th 2002
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The trouble with pyramid schemes

Prosperous Ponzi

THE offer to double your money in 90 days seemed too good to be true. But once the first people to sign up were paid the promised return on their investment, more and more punters queued up in Boston to put their money into the “Securities Exchange Company”. Charles Ponzi had devised a classic fraud: extravagant payouts to the first investors were easily financed by the growing numbers of those who followed. But not indefinitely. Once the fraud was uncovered in 1920, Ponzi was sent to jail.

Fifteen years later the American president of the day, Franklin Roosevelt, signed the law establishing Social Security, the name America gives to its public pension system. The first pensioner to benefit was Ida May Fuller, a spinster from Vermont, who had paid the grand sum of $24.75 in contributions. Her first monthly Social-Security cheque in January 1940 was for almost as much. Miss Fuller lived to be 100 and received benefits totalling $22,889.

As it happens, the pension scheme that proved so beneficial to Miss Fuller relies on much the same principle as the Ponzi scam. America's Social-Security scheme is the pay-as-you-go sort in which today's workers pay for today's pensioners. The first few generations of pensioners received much more in benefit than they had paid in contributions. These windfall gains arguably continued until quite recently because the PAYG system was extended to cover more and more workers, and contribution rates kept going up.

Paul Samuelson, a Nobel-prize-winning economist, pinpointed the Ponzi characteristics of pay-as-you-go pensions back in 1967. “The beauty of social insurance is that it is actuarially unsound. Everyone who reaches retirement age is given benefit privileges that far exceed anything he has paid in...Always there are more youths than old folks in a growing population. More important, with real incomes growing at some 3% a year, the taxable base upon which benefits rest in any period are much greater than the taxes paid historically by the generation now retired...A growing nation is the greatest Ponzi game ever contrived.”

Me too

After the second world war, politicians in most developed countries joined in the game with gusto. In the 1960s and 1970s, they made state PAYG pensions even more unsound by introducing big hikes in benefits. To this day, PAYG schemes remain the main form of pension provision the world over. They are especially important in the EU, where they account for nearly 90% of total pension income. Even in Britain, where the PAYG scheme is much less generous than in most of continental Europe, it accounts for 60% of total pension income.

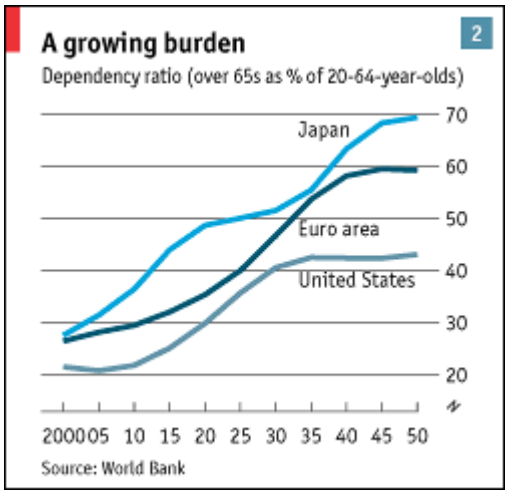
Yet all the while the foundations of PAYG schemes were being undermined. As Mr Samuelson had pointed out, the underlying return from this kind of pension comes from the growth in the workforce and its real earnings. But in the 1970s, the post-war baby-boom gave way to a baby-bust which put an end to the indefinite prospect of “more youths than old folks”. Besides, those “old folks” were living longer because of an unprecedented rise in life expectancy at older ages. At the same time the post-war surge in productivity and hence real wages gave way to much more pedestrian growth rates.

What has saved PAYG schemes so far is that demographic developments take a long time to work their way through the system. The schemes are still benefiting from the large number of post-war baby-

boomers in the working-age population, who will not start to enter retirement for another decade or so.

Today's problems arise largely from over-generous increases in pension benefits that have already pushed contribution rates to the limit. Americans worry about a Social-Security contribution rate of 12.4% of pay, but Germans have to put up with 19.1%, and even that does not make German pensions self-financing: without a subsidy from general taxation, the contribution rate would have to be 25%. In Italy, the contribution rate is an astonishing 33% of eligible pay.

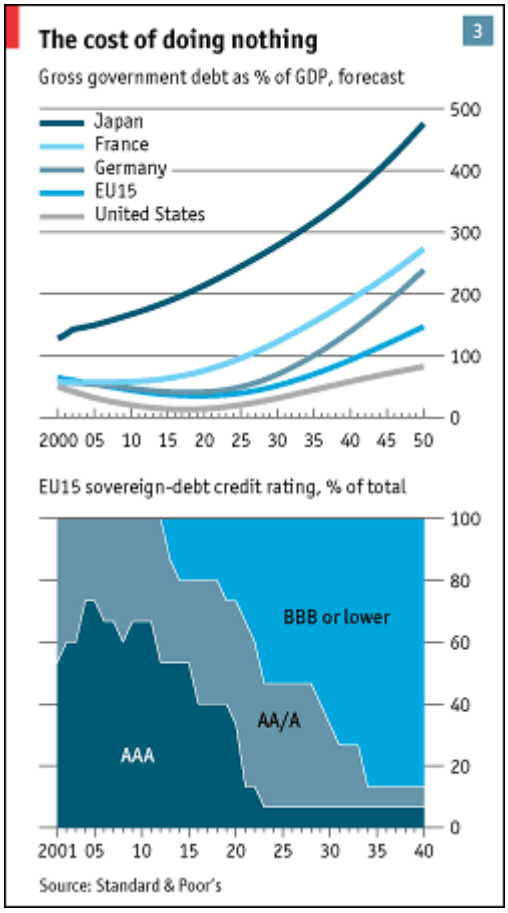
The worst is yet to come (see chart 2). Over the next 30 years, western populations will age at a record rate. The ratio of the over-65s to those aged 20-64 will double. Japan's working-age population, already declining, will shrink drastically. Something will have to give. Either benefits must halve in relation to average incomes; or contribution rates—already oppressively high in many countries—must double; or the retirement age must go up.



Running out of credit

If governments were to leave matters as they are, they would eventually have to borrow to bridge the gap between future pension outlays and tax revenue. Standard & Poor's, a credit-rating agency, has recently done the sums and found that some countries in the EU, where pensions are especially generous, could pile up liabilities on the scale of war debts. By 2050, nine of the EU's 15 member states would have accumulated gross debt of 150-300% of GDP.

Long before then, this debt build-up would have led to a drastic downgrading of credit ratings. As early as the 2020s, a majority of the current 15 EU states would suffer the indignity of being assigned BBB credit ratings, currently the preserve of borrowers such as Egypt. Japan's credit rating would nosedive even further, because its debt—already about 140% of GDP—would rise to almost 500% by 2050 (see chart 3). According to Moritz Kraemer, a sovereign-ratings analyst at Standard & Poor's, “Such a deterioration in credit ratings is inconceivable.”



The exercise simply underlines the need for reform. With mounting resistance to further hikes in contribution rates, harsh cuts in benefits appear inevitable. Since PAYG pension benefits are not property rights, their future value will be determined by the unpredictable votes of future electorates, who will have reason to say enough is enough. “The PAYG pension is a political claim, and at some juncture the burden will be so great that workers will use the polls to reduce it,” says Sylvester Schieber, research director at Watson Wyatt, an actuarial consultancy.

In Germany, real returns on PAYG pensions are set to fall drastically, from about 3% for those retiring in the 1990s to -1% around 2040, calculates Axel Börsch-Supan, a pension specialist at Mannheim University. A negative return means that the real value of future benefits after retirement will be less than that of all the contributions paid in. In America the picture is less bleak, but even there returns will eventually drop to 1% if contribution rates stay the same. Such poor value makes the overloaded pillar of PAYG pensions highly vulnerable.

Most state pensions and company plans have another crucial flaw. They offer a defined benefit at a given

retirement age that has long been rendered obsolete by demography. In recent times the life expectancy of a 60-year-old has been going up by one to two years per decade. That is cause for joy for 60-year-olds, and makes a defined benefit from that age increasingly valuable for them. But it also makes that benefit more expensive for the provider.

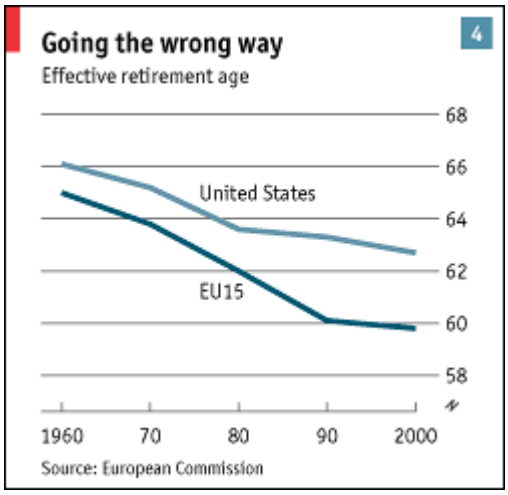
Belatedly, governments are trying to amend this feature of their pension schemes. In America, for example, the normal pensionable age, fixed at 65 in 1935, is due to rise to 67. But this reform, agreed in 1983, only starts to take effect next year and will not be fully phased in until 2027. Meanwhile the life expectancy for a 65-year-old American male has increased by nearly two years in the past 20 years, so the reformers are back where they started.

The country that has seen the most striking increase in life expectancy at older ages is Japan. Noriyuki Takayama, an economist at Hitotsubashi University in Tokyo, explains: “The key issue for pensions is defined benefits, not pay-as-you-go. In Japan today all the problems are coming from defined-benefit pledges that cannot be met.”

A further problem with DB pensions is that the supposed relationship between the duration and level of contributions and the eventual pension is usually tenuous, undermining the idea that such contributions are a form of insurance premium; instead they are seen as a tax. As a result, more and more people try to escape what they see as an onerous impost. “In Germany people are voting with their feet,”, says Mr Börsch-Supan. The proportion of the self-employed making discretionary contributions to the pension system fell from 60% in the mid-1980s to 20% in the mid-1990s. In Japan, a third of self-employed people no longer contribute to the basic pension system.

Employees do not have that option, but can take advantage of other exit routes, notably disability or special unemployment schemes for older workers. In many European countries these have, in effect, been providing early-retirement benefits.

All this has helped to promote the spread of early retirement. Never mind the official pensionable age: the effective age of retirement is often about five years lower (see chart 4), which is making public pension schemes even more unaffordable. The OECD has given warning that a continued exodus into early retirement could prove as damaging to future living standards as population ageing itself.



One important reason for introducing DB schemes in the first place was to combat poverty in old age and promote income redistribution. But the results are often at odds with the good intentions. For example, poorer people tend to die sooner than the better-off, so they may draw their pensions for a shorter period, or may never reach pension age at all. Likewise, one-earner couples in America, who tend to be comfortably off, do well out of unearned spousal pension benefit. “Social Security is a big middle-class transfer system, so it is much less redistributive than its defenders argue,” says Olivia Mitchell, a member of the commission on Social Security that has just reported to President Bush.

The redistribution that DB pay-as-you-go pensions undoubtedly achieve is to transfer money across generations, from young to old. But this is not always a good thing. Charles Horioka, an economist at Osaka University, says that in Japan, where the scale of the transfer is especially large, “There is enormous inter-generational inequity as contributions keep on going up while benefits keep on going down: the later you're born, the worse the deal.” The more strongly this inequity is felt by younger people, the greater the likelihood that the system will prove politically unsustainable.

Private grief

Company DB plans, which have been the most common form of private-pension provision, can have equally perverse effects. Typically, the pensions they provide depend on final salary and years of service. They favour long-standing employees, especially those who rise through the ranks and whose salaries go up steeply in their final years at work. By contrast, they offer poor value to early leavers or employees whose earnings peak early.

A big point in DB company plans' favour is that employers usually contribute generously to them. Such pensions are in effect underwritten by a company guarantee. If times are hard, companies step up their contributions to ensure that there is enough money in the pot for existing and prospective pensioners. But these virtues are outweighed by DB schemes' vices. Ever since they started a century ago, they have relied upon a systematic transfer of resources from early leavers to those who stay the course, explains Leslie Hannah in a history of British occupational plans. This kind of inequity has persisted: until last year, Germans joining a company scheme generally had to wait ten years (now reduced to five) before acquiring rights in the plan.

Legislation in Britain has helped to mitigate the loss of pension benefits to early leavers, but the structure of final-salary schemes is inherently ill-suited to workers who change jobs frequently. This is because the pension benefit is “backloaded”: early years of service become more valuable as pay increases with age. It offers the wrong incentives in a labour force bulging in the older age-groups as the post-war baby-boomers pass into middle age, creating strong cost pressures on firms to push out older employees. Both in America and in Britain, early departure from the workforce has been blamed on final-salary schemes.

Equally important, the final-salary structure discourages the sort of flexibility that a successful labour market needs. DB pensions impose “job-block”, says Richard Hinz, pensions-research director at America's Department of Labour. By rewarding long-stayers, they penalise labour mobility, clogging up one of the main mechanisms that allow economies to respond to shifts in demand.

In Japan, corporate DB pension arrangements—which include lump sums paid out at retirement—are contributing to the country's current economic malaise. “Companies are overmanned with middle-aged workers who lack motivation and skills,” says Naohiro Yashiro, president of the Japan Centre for Economic Research. Such workers will not leave voluntarily because they have every incentive to stay put, and legal restrictions make them hard to sack. Knowing that they cannot fire older people, companies will not hire them in the first place. A survey conducted in 2000 by Atsushi Seike, an economist at Tokyo's Keio University, showed that 80% of newspaper recruitment advertisements imposed upper age limits.

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Hopeful Houdinis

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Springing the pay-as-you-go trap

EPA

Boosting the West's pension funds

TWENTY years ago the Chilean government took a bold step to extricate itself from its pay-as-you-go pension system. It switched to a funded system in which pension benefits are paid from savings and the returns on them. The Chilean reform has since provided a model, made even more appealing by the boom in financial markets over the past two decades, for reforms elsewhere in Latin America. The gross rate of return earned by Chile's pension funds from their inception to the end of 2000 averaged 11% a year after inflation.

By contrast, the returns on pay-as-you-go pensions have looked increasingly lacklustre in recent years. But comparisons between returns on financial investments and PAYG need to take full account of the different kinds of risk they face. With PAYG, the main risk is political: that governments may decide to make benefits less generous. Equities and bonds, on the other hand, face investment risk. A funded system is also more expensive to administer. When these factors are fairly accounted for, the advantage of funding over PAYG becomes less marked.

Investment risk was increasingly overlooked in the long bull market of the 1990s, but the bursting of the equity bubble in 2000 issued a brutal reminder. Over the past two centuries, real annual returns on United States equities have averaged 7%, but people retire only once. Their problem is, first, that equity markets are volatile, and second, that those markets go through long periods of feast and famine. For example, in the 1970s shares did poorly in both America and Britain, but returns since then have been exceptionally high. By contrast, returns in Japan were excellent in the 1970s and 1980s, but since early 1990 the equity market has been in trouble.

“The problem is the persistence of returns in either direction,” says Gary Burtless of the Brookings Institution in Washington, DC, who has calculated the returns and volatility of equity investments over the past 75 years across several countries. His research shows that even in America, where returns have been the highest and the second least volatile (after Britain) of the countries studied, there was a 10% chance of getting no return at all from investments in equities held over 15 years.

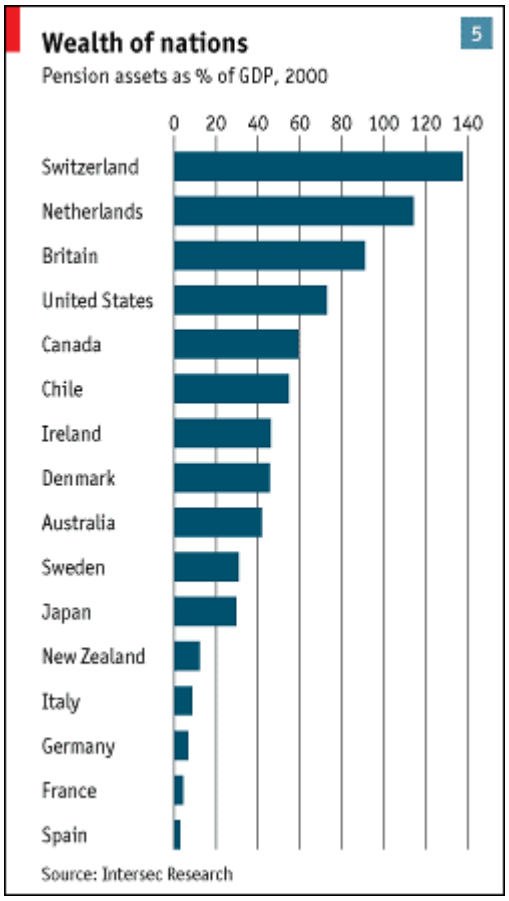
The obvious way to shed some of this risk is to hold portfolios that mix bonds and equities. Returns on bonds are much less volatile than equity investments. Yet most bonds issued by governments and companies are susceptible to unexpected rises in inflation, because interest rates are fixed and the principal is repaid at face value. The unexpected upsurge in inflation in the 1970s slashed the value of bonds, undermining investors' confidence.

There is another snag to funded pensions: they are not as immune to adverse demographics as many people think. This is because the rate of return on capital is likely to fall in response to population ageing. Capital will become more abundant and labour will become scarcer. In the financial markets, the generation seeking to cash in its financial assets will be larger in relation to the generation seeking to acquire such assets, thus reducing returns. However, simulations suggest that the effects ought now to be mitigated by ample investment opportunities in emerging-market economies, where high returns on capital should still be available.

Funded schemes also compare badly with PAYG on administrative costs. Social-security systems can be run cheaply, and the costs do not affect the underlying PAYG return, which in essence is the growth in the wage bill. In funded systems, charges directly affect the rate of return, so it is important to keep administrative costs down. In Chile, such costs have cut returns by almost two percentage points. With

care, lower charges should be achievable. In Sweden, where new mandatory private retirement accounts were introduced in 2000, average annual charges should fall below 0.5% of fund values, according to Hans Jacobson, director-general of PPM, the clearing-house for the accounts. In America, the president's commission on Social Security reckons the annual charges could be kept down to only 0.3%.

These adverse factors bring forecasts of future returns on funded schemes down to much more sober levels than the spectacular returns seen on equities during the past 20 years. The president's commission assumes a rate of return, net of administrative costs, of 4.6%. In Italy, Elsa Fornero, director of CERP, a pension-research centre at Turin University, has used a net return of only 3% in simulating a move towards funding. Such returns are no longer exotic, but they are still much more attractive than the underlying rate of return on a PAYG pension scheme, which equals the growth in total wages and salaries in the economy. In the EU, this will be around 1.75%, the same as the trend rate of productivity growth across the region. If workforces decline in some European countries, as they may well do, the rate of return will fall even further.



Now comes the final, hardest hurdle. No matter what pension scheme is currently in operation, any past PAYG system will inevitably have built up a debt because early generations, in effect, have borrowed from those that followed. In America alone, that liability runs to $9 trillion. Such debts have to be serviced. If the pension system remains pay-as-you-go, that servicing charge drags returns to future pensioners below the underlying PAYG rate. If the system is converted to a funded one, the past debt becomes an explicit government liability through the issue of bonds. Interest paid on those bonds has to be subtracted from the superior returns on the funded system. The winners will be future generations, but there are bound to be losers both among today's workers and today's pensioners.

The case for funding

A shift towards funding is nevertheless essential, for three main reasons, all to do with the role of reform in boosting economic growth. This is the heart of the matter. After all, if the kind of pension system chosen made no difference to the size of the future economy, then reform would simply change the way income is distributed between and among generations.

The first likely benefit of a funded system will come through extra saving. This will lead to faster growth in investment, which in turn will push up GDP. A bigger national economy will ease the distribution struggle between old and young. Some of the extra saving will also flow abroad, which will eventually boost national income through the investment returns on national wealth held overseas. As western countries age, it makes sense for them to draw some of their pension benefits from the return on overseas investment. This benefit is especially valuable for smaller economies, a point that has not been lost on the Swedes. In the first year that they were able to put their public-pension money into private funds, half was invested overseas, says Mr Jacobson.

The second benefit of funding will come through the labour market. The best solution to the economic problems of population ageing is for people to work longer. If retirement incomes depend to a much greater extent on personal savings in pension accounts, then most of the current incentives to retire early will disappear.

A third benefit in countries currently without big private pension funds is that reform will promote the more efficient use of capital and encourage managements to concentrate on shareholder value. This is a particularly strong argument in Germany as the country starts to phase in partial pension funding. “It is a shot in the arm to financial markets,” says Dieter Bräuninger, an economist at Deutsche Bank. “It will bring broader and deeper markets, and promote more effective corporate governance.” To him, this is the main point of Germany's partial move away from PAYG to funding.

Such views are also winning favour in Tokyo, and not before time, given the heedless expenditure of capital that has driven down returns, sometimes to negative rates. “Asset management is becoming more and more important for the soundness of the economy,” says Kazuhisa Okamoto, managing director of Barclays Global Investors in Japan. Since the Japanese are already heroic savers, Mr Takayama of Hitotsubashi University does not expect a shift towards partial funding in the Japanese state pension system to produce a great deal of extra saving, but it “would be better directed and diversified”.

All in all, whereas PAYG systems can work satisfactorily in youthful populations—albeit by creating a big implicit debt to future generations—funded systems are better suited to ageing populations. They help to boost investment at home and allow the diversification of pension provision into overseas economies. They create strong financial and structural incentives for people to work longer. And they help make capital work harder, an increasingly important component of growth in advanced economies.

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Doing it their way

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Different countries, different routes to funding

AP

Riester comes up with a nest-egg

WHEN you are in a hole, stop digging. It's as good a rule of thumb for economic policy as for anything else in life. And as far as its pension system is concerned, Germany has now put away the spade.

Walter Riester, the labour minister responsible for the reform that has just got under way, had one main objective: to stabilise the contribution rate. This had become an overriding political priority. The limit on taxing workers to support pensioners had been reached even in a country prepared to tolerate high taxes. The new regime is designed to keep contributions, paid jointly by employers and employees, below 20% of eligible pay for the next two decades and to a maximum of 22% by 2030.

That paved the way for the second element in the reform, which in effect introduces partial private funding into the state pension system. Starting this year, Germans can put 1% of eligible pay into their own retirement accounts. This will rise in steps to 4% in 2008. With generous subsidies to encourage take-up by low-earners and parents with dependent children, the government expects 80% of private-sector workers to take part.

Fixing the contribution rate when the ratio of pensioners to workers is rising means that pension benefits must fall in relation to average wages. The German government insists that the decline will be small, from 70% of net (post-tax) wages to a minimum of 67% for the average pensioner, but this disguises a change in the formula used to calculate pension entitlement. On a like-for-like basis, pension benefits will decline to 64% of net wages.

Critics initially dismissed the German reform as too faint-hearted, a judgment reinforced by the government's statistical sleight-of-hand. But increasingly the change is being recognised as a breakthrough. Unlike earlier reforms, which sought to bring down the cost of PAYG financing, the Riester reform changes the entire pension system to include private funding. “Germany has taken a bold step down the road of pension reform towards a new pillar which is pre-funded,” says Gert Wagner, an economist at the German Institute for Economic Research in Berlin. At the end of last year it was extended to include civil servants. And if things go worse than expected, the government has committed itself to taking further measures to keep the contribution rate down.

Already, there are many signs that the reform will have a much bigger effect than at first seemed likely. Ironically, this is partly because the trade unions, which started off by fighting the introduction of private retirement accounts, are now taking advantage of the new opportunity to set up pension funds. Even before the legislation took effect at the start of this year, occupational schemes had been established in sectors such as engineering and the chemicals industry. These new funds have also been given a much freer hand over their investment than was previously allowed for pension portfolios. The total build-up of private pension capital resulting from the reform could reach *euro*160 billion ($138 billion) by 2009, according to Deutsche Bank.

Yet for advocates of funding, the German reform is inherently disappointing because it grafts a funded branch on to a PAYG trunk. And indeed this trunk should have been lopped more extensively: further cuts in benefits will probably be needed to keep the 22% cap on the PAYG contribution rate. But there are solid reasons why a radical change along Chilean lines is both impractical and inadvisable for a highly developed country such as Germany.

Transitional trouble

The longer a PAYG pension system has been going and the more generous its provisions, the bigger the build-up of implicit debt in the system. Because of this heavy transition burden, no country with a large PAYG pillar can make a rapid switch to a funded-only system. This would impose most of the double burden on the current working generation, who would have to build up their own funded pensions as well as financing today's pensions for yesterday's workers. The only practical way to proceed would be to spread the transition over a longer period.

But even if a rapid transition were possible, it would not necessarily be a good idea. Just as investors seek to diversify risk, so pension systems should try to spread theirs. If it makes sense to hold lower-return but less volatile bonds in a financial portfolio, it makes sense to hold lower-return but less volatile PAYG rights in a pension portfolio. “Funding is part of the solution but not the whole solution,” says Nicholas Vanston of the OECD. “So if one has both PAYG and funding, the overall system is less risky.”

The German reform is a useful example of how, in practice, policymakers can deal with an overburdened PAYG system. If you have reached the political limit on your contribution rate, then you must offer the working generation an alternative means of pension saving, says Mr Wagner, the economist. Otherwise you condemn them to relative poverty in old age. In effect, what you are doing is to bring forward the partial default that is bound to happen to PAYG pensions, and giving individuals a chance to respond while they still can.

Where Germany has led, Italy hopes to follow. The need is urgent. Despite reforms in the 1990s, Italy's pension system still absorbs a huge 14% of GDP. Future benefits have been cut, but a long transition period has put off the pain. The main sufferers will be Italians born after the mid-1960s, who will pay in more than they get out. “The system needs redesigning to shorten the transition period, raise the retirement age and introduce a private funded component into pension provision,” says Elsa Fornero of Turin University.

The Italian government announced new proposals for reform at the end of last year. These will take advantage of the country's unusual severance-pay system, under which 7% of earnings are held back until an employee leaves the company. The plan is to divert this flow of money, worth around *euro*15.5 billion a year, into private retirement funds.

At present, the severance-pay system provides firms with cheap working capital. It also allows employees to build up a convenient pot of saving which they can dip into if they want to buy a house. Earlier attempts to get this money switched into retirement saving failed because both employers and employees find the present arrangement so useful. The government is now offering employers, who are the main contributors to the PAYG system, a reduction of three to five percentage points in the contribution rate for new employees. But those employees will be getting the same benefits as everyone else, so the pension deficit will increase further.

A glaring omission in the plan is any attempt to tackle “seniority” pensions, which allow a generation of older workers to retire with disproportionately generous benefits after completing 35 years' work. The government's (risky) strategy is to force the development of pension funds and to show that private-pension saving works. Only then will it tackle the financing problem within the PAYG system.

The virtue of saving

Germany's new pension law and Italy's reform proposals both feature private retirement accounts, but in principle it should make little difference whether the money goes into private accounts or into a public fund that buttresses the PAYG system. The main point is to encourage more saving to create extra resources for investment.

To see whether it works in practice, look at America, where reforms in 1983 introduced partial funding of the Social-Security system. Today's payroll tax of 12.4% of eligible earnings is about two percentage points higher than what is required to pay benefits. These excess contributions, together with interest, have built up a trust fund, held in Treasury bonds, which now exceeds $1 trillion and will rise to over $3 trillion in today's money at its peak in 20 years' time.

Such a fund does not constitute a direct financial claim against an external counterparty. Instead it

earmarks future public revenues, which will be called upon to pay for the redemption of the bonds. It helps in dealing with future pension liabilities only to the extent that, allowing for the trust fund, net public debt and hence interest payments are lower than they would otherwise be. But the slew of Social-Security surpluses since 1984 allowed the rest of the federal budget to run higher deficits, so undoing much of the burgeoning trust fund's good work. In 1999, politicians from both parties appeared to have resolved this problem by promising not to dip into the Social-Security surplus. But this so-called "lockbox" was swiftly reopened by Congress last year to finance higher federal spending after the terrorist attacks on America. The lesson is that internal funds promise more discipline than they deliver.

Sweden has recently tried a politically more sustainable tack by reorganising its public-pension reserves—formerly held mainly in governments bonds—into four competing funds that can make big investments in overseas assets and equities. Ireland has started to invest 1% of national income a year in a similar fund. France is experimenting on a smaller scale, with a fund that is expected to reach the equivalent of 10% of GDP by 2020.

The worry is that political interference will stop such funds from being invested wisely. This may be less of an issue in smaller countries that will put the bulk of their funds in overseas markets, but it is a genuine problem in bigger countries that will invest large amounts in domestic equities and bonds. Looking back on America's experience with municipal and state funds, Olivia Mitchell, a member of the president's commission on Social Security, puts it bluntly: "A large federal fund would find its investment decisions blighted by politics."

Japan's experience with investments financed by public-pension reserves built up within its PAYG scheme has been disastrous. "The reserves may not exist because of so many bad loans, after being used to build highways and roads that are scarcely used," says Mr Yashiro of the Japan Centre for Economic Research. The government is belatedly seeking to put this right by reorganising the reserves as a separate fund with clearly defined fiduciary responsibility to pensioners. Investments in the market will be carried out by private fund managers, but the risk of political interference remains because a government minister will have the final say in overall investment policy.

There are two other weighty reasons why privately held funded accounts within a state pension system are preferable to purely public funds. First, only private accounts can generate real ownership. Second, only private retirement accounts can support a defined-contributions system, and only a DC system will persuade individuals to take charge of the most important decision of all: when to retire. As long as pension systems lay down fixed retirement ages, they will be scuppered by rapidly rising life expectancy. The only long-term answer is to make people responsible for taking that decision themselves—and budgeting for it.

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A matter of definition

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But which, benefits or contributions?

AP

So much for Enron's DC pensions

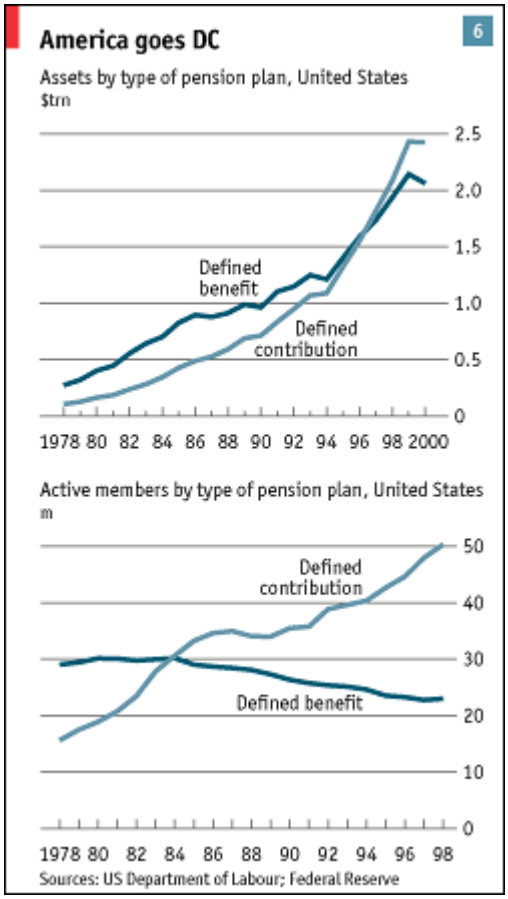
THE early 1980s were a blue-riband period for pension reformers. Chile not only switched from PAYG to funding, but also moved from a defined-benefit to a defined-contribution system of compulsory private pensions. And in America, the tax authorities gave the green light to an obscure provision in the tax code to foster private retirement saving. That was the start of the 401(k) pension plan, which put American private pensions firmly on the defined-contribution track and set an example for individuals around the world on taking charge of their retirement saving.

Back in 1980, most American workers with private-pension provision were in defined-benefits plans, which had spread widely since the second world war. At the peak, around 30m Americans—two-fifths of private-sector employees—were covered by DB schemes. Many of these were also covered by supplementary defined-contributions plans financed by employers, but such plans were the main source of pension provision for only 6m workers.

By contrast, most Americans building up private pensions today do so through DC schemes. What has made the difference is the emergence of the 401(k) plan, which allows employees to make voluntary contributions, generally half-matched by employers. These schemes have given individuals a much clearer sense of ownership and control, both in the level of contributions and the choice of investments. As a result, the number of people in DC plans more than doubled in less than two decades, whereas membership of DB pension schemes fell to 23m. Remarkably, DC plans overtook the much longer-established DB schemes in value of assets in 1998 (see chart 6).

Surely such an important breakthrough must have been as carefully conceived as a test-tube baby. Not so. Richard Hinz, director of pensions research at America's Department of Labour, calls it the “accidental pension”. As he points out, if any legislator had planned the reform, he would have proudly attached his name to it. Instead, the obscure 401(k) label has stuck.

Accidental or not, the 401(k) plan was an idea whose time had come. It attracted companies that wanted to reduce the financial risk posed by DB pension funds. This risk had become more apparent in the 1980s as regulations were tightened up and accounting standards became more exacting. Companies that already had a DB plan often added a DC one alongside it, whereas companies launching a plan for the first time chose DC.



You can take it with you

More important, DC plans appealed to many workers, particularly those who did not intend to stay with their company for life. There were a lot of those around in the 1980s as the big post-war baby-boom generation crowded into the workforce, increasing the number of young and typically mobile workers. Here for the first time was an employer-sponsored plan that allowed individuals to take the initiative in their retirement saving.

Because DC accounts were readily transferable, they promoted the labour-market flexibility that stood the American economy in such good stead in the 1990s. Unemployment fell to lows that in the past would have made inflation take off. Instead, the expansion was sustained for a record length of time.

DC plans have their faults, as demonstrated by the collapse in December of Enron, once America's seventh-biggest company. Over half of its employees' 401(k) pension assets had been invested in the company itself. Following the Enron debacle it also emerged that employees' 401(k) funds at several blue-chip American firms, including General Electric, were even more heavily invested in their own company than at Enron.

On the face of it, all this seems to suggest that DC pensions are riskier than DB ones. After all, the buck no longer stops with the company, but instead with the employee, who must take responsibility for the investments in his DC plan. Still, provided that contributions to the DC plan are made at the same rate as into the DB plan, that shift in the burden of risk may not be all bad from the employee's point of view. This is because the corporate guarantee of a defined benefit comes at a price: if better-than-expected returns generate a surplus in the pension fund, the company usually gets to keep it.

The truth is that both sorts of plan are risky, but in different ways. With DC plans, the hazards are easier to spot: members face investment risk when building up the fund, and need to cover against longevity “risk” (the welcome possibility of exceeding their expected lifespan) when they cash in the fund to buy an annuity.

DB plans should offer protection against these two eventualities. However, they expose employees to two other kinds of risks that are less obvious but just as important. The first is that the growth in their earnings will flatten out early in their working life. This means they will gain much less from a final-salary scheme than colleagues whose earnings peak at the end of their career. The second is the possibility that they may leave the company. If they do, their eventual benefits (or the transfer value of their pension

fund) will be much lower than if they were to stay with the same employer.

So which of the two different sets of risks is greater? Mr Hinz at the Department of Labour has conducted a simulation for 100,000 representative American workers that compared their eventual pension benefits under DB and DC regimes, assuming that the total value of contributions into the two types of plan was the same. His surprising conclusion is that DB plans are riskier than DC ones: the expected value of pension benefits varies more under a DB than a DC regime. The main reason is that some individuals (long-stayers, high-fliers) do extremely well out of DB schemes, whereas others (early leavers, plodders) do not.

The lesson to be learnt from the Enron debacle is that DC plans, like any other form of investment plan, need some basic safeguards. Their absence in the DC system may reflect its origins as the “accidental” pension. Those faults must be put right. But they do not discredit the principle behind DC pension plans.

The main weakness in such plans in America lies elsewhere: in their coverage. At present a third of the workforce lacks any private retirement saving. This may change if the proposals of the president's commission on integrating private retirement funds into the Social-Security system are adopted, but certainly not for a while.

The commission outlined three options for reform, all of which were designed to allow American workers to divert some of their Social-Security contributions to build up their own retirement savings in the form of voluntary funded accounts. The trade-off would be lower traditional benefits. Along with a shift towards partial private funding, this would introduce the DC principle into the state pension system.

The snag with diverting some payroll taxes into private retirement accounts is that it will increase Social Security's underlying deficit for a long transition period. Only one of the three options advocated extra contributions. In the majority-backed proposal, the shortfall in revenues during the transition period would total almost $1 trillion in today's money.

To deal with Social Security's long-term financing problem, most commission members backed a big cut in future benefits. This would be achieved by uprating new pensions only in line with inflation rather than with average earnings from 2009—a recipe for much less generous benefits in the long term than under the current formula. But pensioners may not be prepared to put up with that. In Britain, where the real value of the basic pension was frozen two decades ago, the government recently had to offer hefty real increases in response to growing protests.

Protected species

That is why the commission's report to the president is in the pending tray for the moment. Touch it and fry: not for nothing is Social Security called the third rail of American politics. Republican candidates in this year's mid-term election are nervous about antagonising older voters. But if Mr Bush's party regains control of Congress, some of the commission's recommendations could form the basis for reform next year.

New retirement accounts of the size suggested by the commission would have only a modest impact. Because of the reluctance to raise contributions, the flow of money into the accounts would be quite small. For example, the first option proposes putting in only 2% of payroll income, and the proposal backed by the majority on the commission caps contributions at $1,000 a year in today's money. By contrast, the cap on employees' contributions to 401(k) accounts is currently $11,000, and joint contribution rates by employers and employees have typically been 10% of income, according to the Employee Benefit Research Institute.

AP

The president's men ponder pension reform

The economic benefits of such a reform would also be quite limited. If, as seems likely, big cuts in benefits prove politically impossible, the only way of achieving an increase in national saving is through additional contributions. The reform will help to make the connection between a longer working life and a more affluent retirement, so promoting more effective labour markets. But unlike Germany and Japan, America does not require pension reform to stimulate more effective capital markets and corporate governance.

All the same, the social and cultural impact of retirement accounts could be significant. The commission hopes that personal retirement accounts will help spread wealth to all Americans, especially members of disadvantaged ethnic minorities. Its report stresses that some of the new accounts could be turned into inheritable wealth—with the proviso that pensioners must ensure they leave themselves with sufficient income to ward off destitution in old age. But these social effects will depend on lower-income Americans taking the plunge, which will require considerable subsidies.

Learning to love DC

Outside America, the spread of defined-contribution pensions has been more hesitant, but they are now beginning to make real inroads into the private-pension market. Again, much of the impetus comes from changes in regulations and accounting standards.

Britain's substantial company-pension funds have mostly been sticking with defined benefits, but in the past year a tenth of final-salary schemes surveyed by the National Association of Pension Funds were closed to new entrants. A fifth of all private-sector schemes are now of the DC kind. A number of factors have been at work. An important incentive for companies to fund generous pension plans was removed in 1997 when Gordon Brown, the incoming Labour chancellor of the exchequer, abolished a rule that had allowed pension funds to receive dividends gross of tax. This change—which shows that funded pensions are not immune to political risk—has made company pensions more costly to provide, increasing the attractions of DC schemes, which are generally cheaper.

British company pension funds have tended to be heavily invested in equities, which represented 75% of fund values in the 1990s, so they have been hit hard by recent setbacks to global equity markets. The London stockmarket lost ground in both 2000 and 2001, the first time since the mid-1970s for this to happen in two successive years. Corporate treasurers have become much more alert to the risk involved in underwriting a DB company-pension fund because of a new accounting standard, FRS17, due to take effect in 2003. This will flush the underlying volatility of a company pension fund out into the open and show it on the company's books.

The switch from DB to DC is causing popular concern, but this is largely misplaced. In Britain, as elsewhere, DB plans look better on paper than in reality. They have also provided a big incentive for people to retire early, which is one reason why they lack friends in Britain's Treasury.

The real reason to worry about DC plans in Britain is that contribution rates are too low and coverage is not wide enough. Typically, companies contribute considerably less to DC plans than to DB plans. Occupational pension schemes now cover less than half of all employees. A new low-cost personal pension plan designed for low-to-middle income earners without an occupational pension scheme was launched last year, but these “stakeholder” pensions have got off to a disappointing start. The jury is out on whether financial education and tax incentives will be enough to promote the required levels of pension saving, or whether the government will have to mandate minimum contribution levels for all workers. There may be more of a need for this in Britain than in other countries because the state PAYG provision is unusually low.

In Germany, where company pensions make up only about 5% of all retirement income, they have traditionally provided defined benefits financed from firms' own balance-sheets; but after the recent reforms employees can now insist that up to 4% of their eligible pay go into a pension plan that enjoys favourable tax treatment. Such saving confers immediate pension rights, with no vesting period. This innovation should give a big boost to defined-contribution private retirement accounts, organised through pension funds. Again, such accounts are likely to appeal to younger and more mobile workers and new businesses.

In Japan, too, companies can now offer DC plans for the first time, which will introduce much-needed portability into pensions. Hitachi, an electronics firm, has announced that it is introducing such a scheme. But Japanese industry in general is being less enterprising. “Most companies are taking a wait-and-see attitude,” says Masaharu Usuki of the Nippon Life Insurance Research Institute. He forecasts new contribution flows of ¥1 trillion-2 trillion ($7.5 billion-15.0 billion) a year.

One reason for expecting a muted response is that the annual tax relief on contributions to these new schemes is grudgingly low—¥216,000 per head where the company already has a DB plan, and ¥432,000 where it does not. These limits are far lower than for America's 401(k) plans. Further tax concessions may well be needed to give the schemes a push. Companies converting existing DB plans into DC ones

will also have to get their employees to agree, which will not come cheap.

Most important of all, only employers can pay into the company plans that will form most of the new schemes; contributions by employees are not permitted. “DC plans will take off only if employees are empowered to contribute for themselves,” says Mr Usuki.

All the same, such plans hold great appeal for younger Japanese who are nervous about tying themselves to one company for life, especially after some well-publicised bankruptcies in which workers have lost much of their lump-sum entitlement. Meanwhile, the tax relief on the traditional lump sum is being phased out. “Initially the impact will be modest, but given all the risks that DB plans have I think that eventually there will be a big shift,” says Kazuhisa Okamoto of Barclays Global Investors.

In Sweden, too, private pension plans—which are organised mainly through five nationwide occupational schemes—are increasingly being switched from DB to DC. But Sweden has gone a step further and introduced the DC principle into the state pay-as-you-go system as well.

The reform was spurred by the crisis in Sweden's public finances during the recession of the early 1990s. In January 1994, all political parties agreed on a wide-ranging reform to the PAYG pension system. This took final legal shape in 1998 and is now being phased in.

One big change was the recent introduction of mandatory private funded accounts. The contribution rate into these accounts is quite low—2.5% of eligible earnings—but the principle is important. Arguably more significant, though, was the invention of complementary “notional”DC accounts within the PAYG plan. These accounts are credited with workers' contributions annually, at a much higher 16% of pay. The account balance “earns” a rate of return equal to the growth in average pay. At retirement a pension “annuity” is paid out that reflects the balance in the account and the worker's life expectancy at the time of retirement.

Critics of the Swedish system say that the reform is as virtual as the accounts are notional. After all, the contributions that are supposed to go into the accounts are in practice paying for the benefits of today's pensioners. Just like a DB pay-as-you-go system, a DC scheme faces the rising dependency ratio caused by ageing. Indeed, some argue that the Swedish reform was a clever way to cut benefits. By 2050, these will be about a fifth lower than they would have been under the previous system.

The most serious weakness in the scheme is that the return on the accounts reflects the growth in average wages, whereas the underlying return from PAYG is the growth in the wage bill. If Sweden's workforce declines, which could easily happen, then benefits will have to be cut still further. Hidden away in the small print of the pension reform are provisions designed for just such a contingency.

Northern virtues

Despite these drawbacks, the Swedish reform has two cardinal virtues compared with a conventional DB pay-as-you-go model. The first is that it creates a much clearer link between contributions and eventual benefits. “This was one of our main objectives because it makes the pension system much fairer,” says Bo Könberg, the politician who laid the groundwork for the reform. Any redistribution is paid for by subsidies from general tax revenues. The system is now clearly designed to provide insurance against old age.

The second virtue of the Swedish reform is that it makes explicit the link between pension benefits and life expectancy in retirement. Swedes can retire on a state pension from the age of 61, but the earlier they retire the lower the pension will be. If on the other hand they choose to continue working, they will get more pension benefit. They can also take a proportion of their retirement benefit while continuing to work part-time.

These virtues have won the Swedish reform fans in unlikely quarters. Sylvester Schieber, who has long pressed for private retirement accounts within America's Social Security system, thinks that “Sweden has introduced a very important structural change that de-politicises the retirement-age decision.”

Variants on the Swedish system have been established in Latvia and Poland. “I believe that the EU will have to go in this direction,” predicts Edward Palmer, research director of the Swedish National Social Insurance Board. Certainly such a scheme could help solve the EU's problem of labour immobility across

borders. Martin Feldstein, an advocate of privatising America's Social Security, has recently proposed converting Europe's PAYG pensions into a notional DC system. That would allow the fair swapping of national PAYG pension rights when individuals work in another EU country.

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Booting out equities

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Was Boots right to switch its entire pension fund to bonds?

Bags of bonds

IN LATE 2001, Boots, a British retail chain that sells prescription drugs, cosmetics and other personal-care products, astonished the world of pension investment by announcing that it had shifted its entire pension fund into high-quality bonds. The decision confounded the investment orthodoxy in favour of equities that had prevailed for the past 40 years. It also, as it happened, turned out to be well-timed because it avoided the worst of last year's bear market in equities and crystallised a pension-fund surplus.

If Boots had simply switched the bulk of its fund into bonds, and kept quiet about it, no one would have paid much attention. After all, Boots' main defined-benefit pension plan is different from that of many British companies in that new employees qualify to join it only after five years at work. Until then, they are offered a less generous defined-contribution plan. Given the rapid turnover of staff in its shops, this means that the company's DB plan is not unlike a “closed” mature fund, which has no new entrants and more and more members either already retired or approaching pensionable age. No one would quarrel with the idea that as a scheme matures, it should match the pensions it is paying out with income from bonds.

But John Ralfe, Boots' head of corporate finance, is arguing that all company pension funds should invest solely in bonds as a matter of economic principle. He maintains that the distinction between a company's pension fund and the company itself is notional, because the company backs the fund. A company whose fund holds equities to meet its pension liabilities is therefore, in effect, borrowing money to invest in stocks. A company with an equity-based pension fund, he says, is like a company running an investment trust on the side.

Many would take issue with this view. For one thing, if the company and the pension fund really were economically indivisible, there would be no point in setting up a separate fund. The point of the fund is that it represents the interests of its members, both working and drawing pensions, although it needs to take the company's interests into account too. And senior figures in the actuarial profession disagree with Mr Ralfe's argument that members' interests are better served by investing only in bonds. “From the corporate treasurer's perspective, it may make sense to hold only bonds, but regulators take a different view: that the fund should be diversified,” says Chris Daykin, the British government's actuary.

Putting a pension fund's entire portfolio into bonds may make it easier to deal with short-term volatility, but pension funds operate on a much longer investment horizon. DB plans are offering a starting benefit that is linked to wages and salaries, so they must ensure that their assets match this accruing pension liability. “The pension rights that workers in DB plans are building up are linked to wages, so you need to match them with a real claim on the economy,” says Mr Daykin.

Cults of any kind are suspect, and a new cult of the bond would be no better than the old cult of the equity. Equities should remain a mainstay of pension funds' holdings because both have long time horizons. If you are planning 40 years ahead, short-term volatility becomes less of a worry.

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Time is running out

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An ageing world needs grown-up pensions

All right for some

PRESENT pension structures no longer work. They were established in a more youthful era with relatively few older people who were often poor and ill, and typically spent only a short time in retirement. In rich countries today, older people are often well-off and in good health, and are spending around 20 years in retirement. Hence the need for reform.

This survey has presented the arguments for more private funding and for actuarially fairer pensions. Such changes will create incentives for individuals to take charge of their own retirement needs rather than leaving the task to the state. This, in turn, will make the provision of public pensions more affordable.

Even so, the state will continue to play a leading part in pensions. At a minimum, governments must offer a safety net, probably in the form of a defined benefit financed through taxation, for people who for some reason have not been able to provide for themselves and who would otherwise be destitute in old age. More broadly, there is a case for the state to offer a slimmed-down pay-as-you-go pension system, although as far as possible this should be organised along defined-contributions lines. Such provision widens the range of assets to include human capital because the effective return comes from total wages, and offers a safe if low return.

Governments also have to create a suitable framework for effective private pensions. Administrative costs have to be tightly controlled, and appropriate tax incentives have to be offered to encourage voluntary pension saving. Where the state provides a generous safety net, private-pension saving may have to be made mandatory, otherwise many people will not bother.

So much for the developed countries; but what of the more youthful populations of the rest of the world? In 1994, the World Bank came down heavily in favour of more funding in private accounts. It thought the state's role should be to provide a smallish first pillar with the limited task of providing protection against old-age poverty, and to mandate a privately funded second pillar to provide the bulk of pensions.

The arguments in favour of something akin to the Chilean model in emerging economies are twofold. First, although the evidence about higher saving is disputed, private pensions certainly stimulate the development of financial markets, which in turn appears to spur faster growth. Funded pension plans in developing economies can also take advantage of opportunities to invest in financial assets outside the country, thus diversifying risk. Second, the West's experience should have made it clear to developing countries that PAYG pension systems are easy to start but difficult to halt: better to avoid them in the first place. Sadly, explains Robert Palacios, an economist at the World Bank, “The vast majority of developing countries are repeating the mistakes that the developed countries made.”

On the other hand, regulating private-sector pensions and keeping down administrative costs is even more difficult in emerging economies than in developed countries. And when economies are growing very rapidly, there is a stronger case for redistributing resources from young to old through a PAYG system because the lifetime incomes of the young are likely to be so much higher. The World Bank is now less vocal in its advocacy of a big mandatory funded second pillar. In both developing and developed countries, the question is not whether pension systems should be mixed, but what is the best way to mix them.

A little done, much left to do

The road map for reform is becoming clearer, and there are encouraging signs that in some quarters it is being followed. Germany's landmark reform establishes the principle of private funding in Europe's biggest economy. The arrival of the euro has intensified the pressure for change, because the differences between member states' pension debts could threaten monetary union. At the Stockholm European Council last year, the stability guidelines for European monetary union were extended to allow for the longer-term outlook for public finances. A recent blueprint for EU reform set out by Kieran McMorrow and Werner Röger, economists at the European Commission, advocates a big shift away from PAYG to funded pensions.

But much more needs to be done. Politicians tend to act only when pension systems are heading for a crisis. With the crunch still more than a decade away, they will be tempted to procrastinate. As Standard & Poor's shows in its projections, in most European countries public finances will get better before they get worse.

It is also essential to choose the right kind of reform. Patching up an overburdened PAYG system by cutting benefits or raising contribution rates is no longer sufficient. Japan's two most recent pension reforms have tried to do this, but have failed to give people an incentive to provide more for themselves through private retirement accounts. This has contributed to Japan's current economic malaise, argues Toshiaki Tachibanaki, an economist at Kyoto University: “People feel very uncertain about their future pensions and try to save more because of this lack of confidence, and this explains why consumer spending has recently been unexpectedly weak.” Even though the Japanese reform introduced in 2000 cut future pension benefits by 20%, it still requires higher contribution rates. But according to Noriyuki Takayama of Hitotsubashi University, “It is no longer feasible to raise contribution rates still higher, so the pension reform doesn't add up.”

Meanwhile, delays are wasting not only time but money too. For every year that economies operate below their full potential because unreformed pension systems keep down participation rates in the labour force, public debt is amassed unnecessarily or surpluses are smaller than they could be. That will make it even more difficult for governments to honour their pension promises in the 2020s and 2030s when the demographic pressures will become overwhelming.

Politicians want to avoid pension reform because they know it will be deeply unpopular. But if they continue to sit on their hands, they will be guilty of failing to fend off one of the most predictable economic and social crises in history.

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Energy trading

The ship that sank quietly

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Enron's collapse was spectacular. Why has it scarcely ruffled the energy markets?

"A HURRICANE in the Gulf of Mexico would have been more disruptive than the fall of Enron." So goes a saying doing the rounds in the energy business. Although it overstates the point, this statement contains more than a grain of truth. Who could have imagined that the world's leading energy-trading company—a colossus that boasted a 25% market share in gas and power trading on both sides of the Atlantic—could go bust without causing widespread havoc? Despite Enron's demise the lights have stayed on everywhere and the gas has flowed smoothly. What is more, no other firm has gone under as a direct result of its collapse.

How can this be? In part, the explanation lies in the fact that Enron was never quite as formidable a force as it claimed. Its reported revenues (of some $100 billion in 2000 and over $130 billion in the first three quarters of 2001) turned out to be more imagined than real. That is because it took to extremes a dubious habit common in its industry: booking the entire value of trades as revenues, rather than merely the profits earned on those trades (a sleight of hand not permitted for financial trading firms such as Wall Street banks). Reporting in a more honest manner deflates Enron's revenues to $8 billion in 2000 (see chart). Its market-share boasts were exaggerated too. The firm probably had closer to a 15% share in the gas and power markets, reckons ICF, a consultancy.

But Enron was still undoubtedly the biggest energy trader in the world. Even in bankruptcy, it remains a bigger player than many rivals. Enron is holding on to enough contracts to maintain a market share of about 5% in America, reckons Steve Bergstrom of Dynegy, a rival energy-trading group that led an aborted attempt to save Enron from bankruptcy through a last-minute takeover. So the fact that its demise failed to rock the market still demands an explanation.

Some analysts point to the fact that Enron's bankruptcy was not sudden, but took place in slow motion. The first revelations of dodgy off-balance-sheet financing came in September 2001. Only after Dynegy pulled out of its takeover, on November 28th, did Enron file for bankruptcy. This gave its counterparties time to untangle themselves. Cheekily, Dynegy takes credit for this. "Our merger delayed the bankruptcy by 30 to 45 days. [Without it] most companies would have been shocked and unprepared for the sudden bankruptcy," says Mr Bergstrom.

Maybe, maybe not. Joe Bob Perkins of Reliant Resources, another energy trader, insists that the markets would not have been disrupted even if Enron had collapsed suddenly. The reason, he argues, is that supply and demand did not change when Enron went bust. Because Enron had turned to an "asset-light" strategy in recent years, eschewing power plants in favour of fancy financial derivatives, its decline did not take much physical supply of gas or electricity off the market. The physical market, Mr Perkins insists, was flexible enough to hold up even if Enron had imploded overnight. In contrast, ICF estimates that the market for financial trading that Enron pioneered has collapsed to a third of its pre-bankruptcy level.

Deregulation works

The physical market's resilience points to the biggest explanation for the lack of a crisis: energy deregulation. Thanks in part to Enron's tenacious lobbying, the sweeping liberalisation of energy markets on both sides of the Atlantic has greatly boosted competition in wholesale gas and power. In every bit of the business, an array of companies now fights for market share. They were able to swoop in as the industry leader faded from the scene.

Even EnronOnline, the firm's successful Internet-trading platform, has been seamlessly displaced by previously struggling rivals, such as the InterContinental Exchange (ICE). Richard Spencer, ICE's chief financial officer, can hardly contain his excitement: “Enron validated the market, they opened the door, they let us in the door, and then they left.” However, he is quick to give credit to the market reform that made his firm's ascent possible. “We hope Washington will see that it's not deregulation that's the problem,” he says. “Here the market had a failure, and it went away almost without a blip.”

It is not only energy traders—market zealots one and all—who give thanks for energy deregulation. So do regulators, an altogether more cautious lot. “Enron's demise proves that liberalisation works,” says Callum McCarthy, Britain's energy regulator. Britain's New Electricity Trading Arrangement was just seven months old when Enron, the market leader, collapsed—and yet the system proved robust. Mr McCarthy's counterparts on America's Federal Energy Regulatory Commission have also made clear that they think deregulation is part of the solution to the Enron debacle, not part of the problem.

Making waves

Although Enron's sinking did not pull down the energy world, it has still produced a few ripples. The biggest of these is closer scrutiny of traders' balance sheets. Because many of Enron's financial fiddles involved hiding debt, investors have been punishing any firms that appear to have over-borrowed (see article).

This has led to a flight to quality, with asset-heavy firms, which were once seen as stodgy, now back in favour. One such company is Dominion Resources, a big American utility with trading operations. Thos Capps, its boss, says: “We don't like mark-to-market accounting and we don't do asset-light trading. We believe that you ought to have your profits and revenues in the same year.”

The industry's reporting standards may never become that conservative, but there is no doubt that Enron's demise has already raised the bar. Take the example of Williams, an Oklahoma-based energy company that delayed releasing its final 2001 results while it worked out exactly how to treat potential liabilities related to its telecoms unit. Despite the fact that Williams was one of the only companies to have reported its 2000 energy-trading revenues on the conservative basis used by financial firms (as the chart shows), its shares took a beating.

Reliant Resources was also punished by the market when it delayed releasing its results by a day earlier this month—even though it explained that its accounting had been too cautious and its profits were therefore higher than previously stated. “Nobody wants to be perceived as Enron-like,” says Reliant's Mr Perkins.

That must seem the cruellest thing of all to Enron. After all, it was the firm's vision and aggressive lobbying that helped to create today's vibrant energy marketplace. Yet not only are its erstwhile rivals dancing on its grave; it now seems clear that the best of Enron's ideas will outlast the ill-fated company. “This industry was championed by Enron when a leader was needed to push deregulation,” says Dynegy's Mr Bergstrom. “Now, the industry has finally figured out that it no longer needs Enron.”

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Corporate debt

The deadliest sin

Feb 14th 2002 | NEW YORK
From The Economist print edition

Investors are as rattled by the size of firms' debts as by accounting tricks

"KILL them all. God will know his own," was the abbot of Citeaux's advice, as the Albigensian crusade merrily butchered heretics and believers alike in the 13th century. Something equally uncompromising is unfolding in the world's capital markets at the moment. Even as companies protest their innocence, investors are putting their shares and bonds to the sword. Accounting worries are supposed to lie behind the panic. But a deeper anxiety infects the markets, and has begun to spread to blue-chip companies, from Ford to Dow Chemical. Suddenly, all sorts of once-mighty companies are being told they have too much debt.

Worries about the size of companies' debts are nothing new in America, where big companies have been heaping on extra borrowings for years. The real surprise has been the violence of the market's reaction. The share prices of debt-saddled telecoms firms, such as WorldCom and Qwest, have fallen by half in a handful of weeks. Tyco, a struggling conglomerate with questionable accounts, finds itself under still fiercer scrutiny for its mountain of borrowings, $12 billion of which fall due next year. Its shares have fallen by more than 40% since the start of the year.

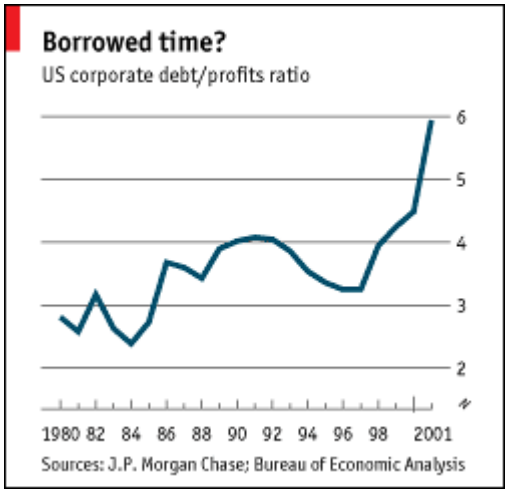
The panic is spreading to bond markets. Bonds issued by Ford, one of the most heavily indebted of the big car makers, yield more than half a percentage point more (over government bonds) than they did at the start of this month—the sort of movement that might normally happen over a year or so. The merest hint of trouble is spreading panic. Bonds issued by Georgia-Pacific, a forestry company with large debts, collapsed in price last month after Moody's, a credit-rating agency, said it might downgrade the company's debt. In Europe, DaimlerChrysler, Deutsche Telekom and Repsol—all companies with big debts—are feeling the displeasure of investors, who are dumping their bonds.

Part of the explanation is that even risky companies have kept borrowing right through the global slowdown. Normally, says Bill Cunningham of J.P. Morgan Chase, the financial markets punish overextended firms at the start of a recession, as a credit crunch rations borrowing among the strong and mercilessly deprives the weak. This time, however, the Federal Reserve cut interest rates so quickly and so deeply that the money has kept flowing. By the end of last September, American companies had combined debts of $4.9 trillion, 6.6% more than they owed at the same point in 2000.

Profits, however, have continued to shrink, making those debts look horribly burdensome. By the beginning of this year, American companies' debts stood at six times the value of their profits, a record (see chart). Stung by criticism that they are too slow and sleepy, America's big credit-rating agencies have suddenly turned hyperactive. Last year, Standard & Poor's, Moody's big rival, downgraded a record five-and-a-half companies for every one that it upgraded. Last month, it pipped even this, downgrading six for every upgrade. Huge bankruptcies like that of Enron, an energy trader, and Global Crossing, a telecoms carrier, have sharpened the atmosphere further.

As companies such as Tyco and WorldCom have discovered, mere demonstrations of the integrity of their accounting have satisfied nobody. Investors are demanding that they shrink their debts as well. To this end, some companies are taking an axe to their investment plans. Last month Mirant, an American energy company, said it would cut capital spending in half this year and next, after Moody's downgraded its debt to junk in December. Others are selling assets to raise cash and pay down debts. This week DaimlerChrysler, whose debt was downgraded by Standard & Poor's in October, said it was selling two car factories, in Austria

and America. Staggering under debts amassed when it bought Fort James Corporation in 2000, Georgia-Pacific is trying to sell assets, such as pulp mills and its building-products division.



The most overborrowed companies are being forced to consider more drastic measures, such as breaking themselves up. This is especially true in the telecoms industry, where companies such as Motorola, which has already jettisoned peripheral assets, are now under pressure to sell core businesses, such as semiconductors.

Suddenly, the great acquirers of the 1990s merger boom are desperately scrambling to undo all that masterful empire-building. Bernie Ebbers, who turned WorldCom into a telecoms heavyweight with a string of bold takeovers, finds himself and his company, which has $24 billion of debt, on the rack. Dennis Kozlowski, the boss of Tyco, cannot undo all his previous good work fast enough: plans to split the company into five have had to be speeded up. Michael Armstrong, another serial acquirer from the 1990s, has escaped the market's wrath this year, but only because his company, AT&T, has already bowed to pressure after seeing its shares hammered over the past two years. In December, AT&T said it was selling its cable unit—along with $25 billion of debt—to Comcast, another American cable company. Until then, stockmarket analysts had been gloomy about AT&T's prospects. Now that it has split itself up, they drool over the “stub” that remains.

The tricky question is how long this humbling will last. Perhaps it is just a normal part of the business cycle—a credit crunch delayed by a year because of the Fed's sharp cuts. Then again, maybe it is the start of something more permanent. Big firms have been adding to their borrowings for decades, squeezing out greater returns for their investors by adding to their financial risks. But shorter technology and product cycles, continuing deregulation and fiercer global competition also keep adding risks to the business environment. Investors may have begun to decide that they do not want to bear the extra financial risks after all. If that is the case, more and more companies may be forced into the most effective debt-reduction method of all: the bankruptcy courts.

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Kirch

Going to pieces

Feb 14th 2002
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Leo Kirch's once-great media empire seems certain to be broken up

DESPITE an offer this week for one of its prized assets, the outlook for the German media empire controlled by Leo Kirch is becoming ever grimmer. HVB Group, a Munich-based bank and one of Kirch's lenders, has offered at least *euro*1 billion ($870m) for Kirch's 40% stake in Axel Springer Verlag, Germany's largest newspaper-publishing group, but it is far from a done deal. Mr Kirch is apparently mulling the offer over, hoping for a higher bid.

He needs to appease his bankers, however, so he has little choice but to sell. Most of Kirch's bank loans, which total more than *euro*5 billion, fall due for repayment this year. Dresdner Bank has already asked for *euro*460m back by April. Last week, Rolf Breuer, chairman of Deutsche Bank, another Kirch lender, questioned whether the banks would continue to throw money at Kirch.

Mr Breuer's bank has first call on Kirch's Axel Springer stake as security for loans of some *euro*700m. So even if Kirch does sell the stake, there will be little left over to meet its other liabilities. For a start, it owes *euro*767m to Axel Springer for that firm's 11.5% stake in ProSiebenSat.1, a quoted German commercial-TV group that Kirch controls. This money is due at the end of April, but Kirch is disputing the validity of legal agreements that govern the terms of the sale.

The real nightmare for Kirch, however, is Premiere, its pay-TV operation. Last week BSkyB, which has a 22% stake in Premiere, said that it will not waste any more money on the business. On the contrary, it wants some cash back. BSkyB, which is part-owned by Rupert Murdoch's News Corporation, has an option to sell its stake back to Kirch for *euro*1.75 billion in October, or earlier if Premiere breaches banking covenants. BSkyB will not say if this is likely, but its announcement last week left the impression that Premiere may run out of cash as early as June.

So it is clear that Premiere will soon require a big cash injection, most likely from an equity investor, if it is to avoid bankruptcy. Given the size of Premiere's operating losses—around *euro*900m in the year to September—and doubts about its business model, investors will be hard to find. Even more so as Mr Murdoch has washed his hands of Premiere for the time being. He may be betting that Premiere will fall into the clutches of its bankers and there will then be a better deal on the table. Even if Premiere goes bust, Kirch would still be obliged to honour BSkyB's put option.

Unlike Mr Murdoch, Mr Kirch does not have time on his side. This is because the solvency of Premiere is critical to his plans for raising money in KirchMedia, a legally separate but closely related part of his empire. Premiere buys pay-TV rights for most of its movies from KirchMedia, which has long-term contracts with most Hollywood studios. Should Premiere default, KirchMedia would pick up the tab.

KirchMedia is in the process of merging with ProSiebenSat.1, and wants to use the deal to take over ProSiebenSat.1's stockmarket listing and raise money through a sale of new shares. Analysts say the flotation, due in the summer, is in jeopardy, though Kirch denies this.

For the flotation to go ahead, Kirch will need to persuade its banks to restructure their loans. The company says negotiations are going well, but getting the support of all its bankers, who have competing interests, will not be easy. If the flotation falls through and Mr Murdoch still wants his money back, Kirch may be left with no alternative but to sell its most valuable asset—its controlling stake in ProSiebenSat.1, which analysts reckon could be worth up to *euro*2.5 billion.

It is not clear whether Kirch's stake in ProSiebenSat.1 is pledged to its bankers, but its other big assets certainly are. Take, for instance, Kirch's controlling stake in the companies that run Formula One (F1)

motor racing, which was acquired almost entirely with borrowed money and is pledged to a group of banks. Even if this could be sold—its former owner, Bernie Ecclestone, F1 supremo, was this week rumoured to be preparing a $700m bid—the proceeds would go to the banks, which have lent about $1.5 billion against the stake. With problems like that, and with Mr Murdoch wanting his money back, Mr Kirch will be lucky if he ends this year even as a minority shareholder in a much-shrunken empire.

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Beauty treatments

Smooth face, big Botox

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A poison turned cosmetic treatment that might be the next blockbuster

AP

A PROCEDURE that uses poison to paralyse facial muscles sounds more like a torture than a beauty treatment. But botulinum toxin A (Botox for short), a biological weapon, is about to get its first official seal of approval from America's Food and Drug Administration (FDA) as a safe way to get rid of wrinkles. Approval, likely next month, will enable Botox's maker, Allergan, which is based in California, to advertise its cosmetic benefits direct to doctors and consumers in America, and could turn Botox into a billion-dollar lifestyle drug to rival Viagra and Prilosec.

When injected in diluted form, Botox relaxes muscle movements that cause twitches and stuttering as well as those distressing wrinkles. At $300-1,000 a pop, the injections are not cheap. Nor is the anti-wrinkling permanent: it wears off within six months. And too much in the wrong places can wipe out all facial expression. But unlike skin creams (a $32 billion industry likened to “snake-oil hope in a jar”), Botox injections produce results within minutes. “This is as close as we have come to an ideal treatment,” says Alan Matarasso, a respected New York plastic surgeon who does up to 30 Botox procedures a day.

None of this is lost on the beauty industry, which sees erasing signs of ageing as the holy grail. Already used for wrinkles for a decade (without FDA approval), Botox is the fastest-growing, most popular cosmetic medical procedure in America. It was used to smooth more than 1m faces in 2000.

Already all the rage among celebrities and well-heeled city dwellers, Botox could now appeal to a broader market. Because Allergan is not allowed to advertise Botox for cosmetic use without FDA approval, many doctors outside big cities do not know about it, says Dr Matarasso. Nor do their female patients. Not that Botox is of strictly feminine interest: men are already trying it for furrowed brows. Robert Bernard, vice-president of the American Society for Aesthetic Plastic Surgery, says that in the softer, post-September 11th era, businessmen tell him they “don't want to look cross in board meetings”.

As more doctors learn about Botox, they are likely to find its profit margins alluring: a $400 vial can yield over $1,600 in treatment fees. Analysts reckon that Allergan's annual sales of Botox, worth $310m last year, could reach $1 billion—the level at which a drug is considered a blockbuster—by 2006. Some will doubtless tut about the vanity of it all. But one woman's meat is clearly also her poison.

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Japanese pharmaceuticals

Swallow the medicine

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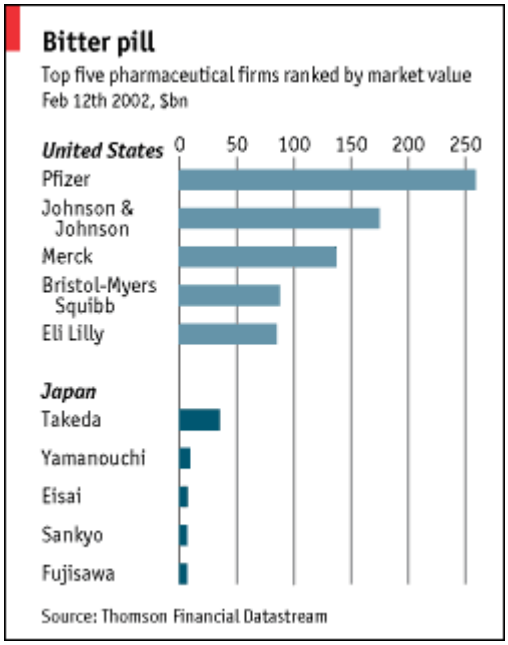
How long can Japan's drug companies continue to go it alone?

OVER the past decade Japan's pharmaceutical companies have mostly clung to their independence even as their rivals in Europe and America have grown bigger by merging and have devoted huge sums to the search for new blockbuster drugs. That began to change in 2001, with a trickle of fresh merger announcements, including one tie-up with a foreign firm. Analysts are now predicting many more deals this year, as the conservative old men who run Japan's drug companies at last pinch their noses and swallow some medicine.

Though they are not well known abroad, Japan's best drug firms have done an admirable job of churning out new treatments. The biggest, Takeda, boasts four big global drugs, which generate $4.3 billion a year in overseas sales. The most successful of these is lansoprazole, which is used to treat ulcers and sells as Takepron at home and Prevacid in America. Takeda also has high hopes for its diabetes treatment, Actos. Mayo Mita, an analyst at Morgan Stanley in Tokyo, expects the drug's overseas sales to quadruple between 2000 and 2005, to $2.4 billion.

Most Japanese drug firms remain crippled, however, by inefficient use of capital. Their returns on equity run below 10%, compared with 30-40% for American and European rivals. Few of them generate the kind of sales growth they need to compete in the research race. Even Takeda, which is far bigger than its nearest domestic rival (see chart), ranks only 17th in the world by market capitalisation, and 16th by sales.

Size is less of a problem for the firms that, like Takeda, have built a global sales base. Since the mid-1990s, Fujisawa has doubled the share of its revenues that come from overseas, to 45%, on the back of such drugs as Prograf, an immuno-suppressant. By contrast, companies such as Sankyo, which derives less than 20% of its sales from overseas, and Tanabe (less than 10%) have to rely on domestic sales prospects, leaving them with little hope unless they find new partners. That is one reason why Chugai Pharmaceutical, almost 90% of whose sales come from Japan, agreed in December to sell a majority stake to the Swiss-based Hoffman-La Roche.



The pressure to emulate Chugai is increasing as foreign entrants invest in Japanese sales forces, obviating the need to pay distribution fees to local rivals. Pfizer, an American giant, now has 1,600 sales reps in Japan, more than any of its local rivals.

Nevertheless, most local managers are still reluctant to take the merger medicine. Last year, Tanabe agreed to merge with another Japanese drug company, Taisho, but the deal soon fell apart. Tanabe now says that it will consider a partner, but only if its research arm can be spun off and left independent, eliminating an obvious advantage of merging. Stephen Barker, an analyst at UBS Warburg in Tokyo, reckons that this could work even so, with Tanabe's research arm becoming more like the small biotech firms that thrive in America and Europe.

Tanabe's example suggests that local firms will continue to guard their independence fiercely, however bleak the long-term outlook. Some will prefer partial deals, like the one that Tanabe has outlined. Those that do opt for full-scale mergers will look for Japanese partners first, hoping that one or two

blockbusters can save the day and help them to expand abroad. But will the easiest medicine to swallow also be the right one?

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Tetra Laval

Boxed in

Feb 14th 2002
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Where next for Europe's biggest food packager?

AP

The future's plastic

GORAN GROSSKOPF is cross. Not surprisingly: the chairman of Tetra Laval, probably the world's biggest liquid-foods packaging company, was recently thwarted by the European Commission, in an attempt to acquire Sidel, a French packaging giant. “The views of the commission are a disaster for European industry,” he complains. “If Europe is to be competitive, we must be allowed to play in the same league as our American colleagues.”

Tetra already plays in that league—in one product. The company was founded by Ruben Rausing, a Swede who invented a way to package treated liquids such as milk and juice in laminated cartons. His grandchildren—two brothers and a sister—still own the whole company, which moved to Switzerland 20 years ago to escape Sweden's hefty inheritance taxes.

Now the company accounts for between half and two-thirds of the world's laminated liquid-food cartons. Its oblong cartons may be tricky to open, but they account for 75-80% of global packaging for “aseptic” milk (briefly heated to very high temperatures) and 70-75% of the same market for juice. Tetra sells its customers wide rolls of laminated cardboard, and sells or leases the machines to fill and seal the cartons. Over the years, the firm has tried to diversify, buying businesses making dairy and food-processing equipment. But its packaging division, Tetra Pak, still accounted for *euro*8.5 billion ($7.4 billion) of the company's *euro*9.3 billion sales in 2001.

Tetra's sales of carton packaging are now expanding fastest in developing countries. In the rich world it is plastic—and especially clear “PET” plastic—that is increasingly the packaging material of choice. Not only can PET bottles contain fizzy drinks that cannot be packaged in cartons; the customer can also see what is in the container, and the material is easier to recycle. PET is becoming cheaper, but cartons are not. Hence the would-be merger with Sidel, the world's biggest maker of equipment for producing PET containers.

Tetra has been trying to break into plastic for some time. Tetra Pak's previous chief executive, Gunnar Brock, left after boardroom arguments over whether to buy a company making plastic containers. The problem: most such companies make containers mainly for products other than food, such as motor oil or detergents, while Tetra wants to concentrate on food.

Sidel thus seemed the perfect partner. Mr Grosskopf thought that he had persuaded the European Commission that the markets for carton and PET packaging were distinct. The commission was unconvinced, arguing that Tetra would come to dominate the PET market in Europe.

Tetra is appealing, but it may never get its hands on Sidel. So it needs another strategy. Nicholas Shreiber, Tetra Pak's chief executive, says the company is looking at possible partnerships, such as one it already has with Graham Engineering, an American firm, to make machinery for bottling milk. It also hopes to adapt its cartons to contain soups and chunky food. In Italy, Tetra Pak is testing, with Nestlé, a “retortable” carton, in which petfood can be sterilised and packaged, a technology that Mr Shreiber thinks will rival the metal can.

But buying a way into plastic packaging will be difficult. All the alternative partners have been snapped up by rivals or are too small to offer scale fast. No wonder Mr Grosskopf is fuming.

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Mobile telephony in Africa

Wireless warriors

Feb 14th 2002 | JOHANNESBURG
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Making calls, and profits, from rough parts of the continent

SETTING up a mobile-phone system in some parts of Africa is tough. Yet nearly 30m Africans now have a cell phone, up from just 2m four years ago. As many now use mobile phones as the fixed-line sort, and the mobile total is expected to double again in the next three years.

The boom in Africa's bigger, richer countries is not new: Nigeria raised $850m from three operators in January 2001, for instance. And the big markets continue to grow. South Africa's third mobile-phone operator, Cell C, claimed over 100,000 customers had signed up in the first 12 hours of business after its launch in November.

More surprisingly, adventurous companies also dare believe in profit from small, poor, war-torn corners of the continent. Since 1995, at least 70 new mobile networks have been licensed in Africa, to the likes of MSI Cellular, Econet, MTN and Orascom. These niche operators dare to tread where larger companies will not. In troubled states—such as Sierra Leone, Congo Brazzaville, Sudan and Chad—demand for reliable phones is soaring, as fixed lines are costly, often fail and are vulnerable to thieves who pinch the wires.

MSI Cellular holds licences in 14 African countries and has invested $400m in the past three years. Its boss, Mo Ibrahim, enthuses that “it is possible to build a western-style company with western standards”. Each operation has become profitable within a year of its launch, he says.

Even in wretched Sierra Leone, battered by civil war and desperately poor, Mr Ibrahim's firm has developed a cell-phone system. MSI Cellular's arrival in the capital, Freetown, coincided with a bloody rebel invasion. After the fighting, British peacekeepers and displaced families were desperate for mobile phones and reliable information. Sierra Leone was MCI's fastest network to reach profitability. Customers are happy to pay upfront in cash, at prices linked to the dollar, which dominates such war-torn economies.

Will the coverage spread beyond Africa's big cities? At 10-14 American cents a minute for a call, firms do not expect returns that justify investing in rural areas for some time yet. So they are likely to expand across borders faster than within them, also spreading the risk that one country tightens regulations or becomes politically unstable. As smaller operators point the way, bigger companies may even begin to show some interest too.

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The future of computing

Let battle commence

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The much-hyped world of web services may be some way off. But the fight over who will dominate it has already begun

IT IS easy to discount web services as yet another fad, but behind the hype surrounding this new way of letting computers talk to each other over the Internet lies a crucial question: who will provide the dominant software platform of the next generation of computing? Already, the battle lines are clearly drawn. On one side is Microsoft, with its .NET plan; on the other an array of rivals, including IBM, Oracle and Sun, touting a technology based on the Java programming language.

This week Microsoft took the battle a stage further, launching a set of tools to develop web services, plus a software framework to run them. This puts .NET on a par with its Java-based competitor (officially called Java 2 Platform Enterprise Edition, or J2EE), parts of which have been available since the late 1990s.

Driving this rivalry is the Internet, which has allowed computing to become increasingly distributed. Today, most advanced applications are accessed using a web browser and run on several machines tied together by the Internet. Web services take this concept further, using standards based on XML (short for Extensible Markup Language). In effect, they use the Internet to turn a network of machines into one huge distributed computer. In the long run, promoters hope, this will produce all kinds of new electronic offerings. One example could be a virtual travel agent that combines various providers' web services for booking flights, ground transport, hotels and entertainment.

To do all this, providers need a sort of operating system that takes care of such things as access to databases and routing of messages. Java was originally conceived to break Microsoft's lock on the PC desktop, but it has ended up being the platform of choice for web-based applications and is now moving to support web services. Microsoft created .NET in an effort to leapfrog its way back into the lead.

The origins of the two platforms help to explain their strengths and weaknesses. Having grown up in corporate computing, J2EE offers what IT managers want: it is reliable, secure and scalable. But it is behind in development tools and XML support. Microsoft has built .NET to make it easy to create web services and use XML. But it still has to prove that its platform is ready for heavy-duty corporate computing.

These differences will probably disappear over time, predicts Yefim Natis of Gartner Group, a consultancy. In one technical respect, however, the two platforms will differ for the foreseeable future. Applications for J2EE can be written only in Java, but they can run on any popular operating system. By contrast, .NET developers can use most languages (except Java), but their programs run only on the Windows operating system. Although there is now an open-source project called Mono, which aims to

build a version of .NET that runs on Linux, the popular open-source operating system, industry analysts doubt that this will ever play a big role.

The reason for this divergence is less technical than philosophical, according to Mike Gilpin of Giga, another IT consultancy. Although Java was originally developed by Sun, the technology today is practically an open standard, collectively maintained by the software firms that sell products based on it. Microsoft, on the other hand, controls .NET, although the company insists that its platform supports open standards better than any other.

Standard arguments

Those in the Java camp say this is a fundamental difference. Because Java is a standard, customers have a choice of J2EE products and can switch between them without being forced to rewrite their applications completely (which will keep vendors responsive and prices in check). Not so, counters Microsoft. Switching from one J2EE vendor to another, it says, is often as costly as switching from J2EE to .NET. Customers would thus be better off picking a platform controlled by one firm than technology designed by committee.

At this point, it is anybody's guess how this platform battle will play out. Optimists predict that whichever platform is deemed the more open will win, because big corporate customers, in particular, no longer want to be locked into one vendor. Pessimists worry that, if the courts let it, Microsoft will abuse its Windows monopoly to dominate the platform for web services as it already dominates PCs.

The outcome will probably be somewhere in between. Even if Microsoft is contained by antitrust remedies, .NET is likely to reign supreme on the PC—but not in the entire consumer market. Java has taken hold in set-top boxes and mobile phones, which now outnumber PCs. In the corporate market J2EE will probably dominate. But many small businesses will choose .NET because they want to spend less, and still find it simpler to get everything from one vendor.

.NET is likely to reign supreme on the PC—but not in the entire consumer market

This market structure would still provide healthy competition—if only J2EE and .NET could connect easily. Such interoperability is not yet possible, but things appear to be moving in the right direction. On February 7th IBM, Microsoft and others announced the creation of the Web Services Interoperability Organisation, which will develop tools to test whether vendors comply with XML standards.

Yet the risk remains that one of these companies will try to dominate the world of web services. In fact, many fear that Microsoft's Passport web-authentication utility, combined with its .NET myServices, a set of basic web services, will one day become a monopoly like Windows. That is why Sun and dozens of other firms have created the Liberty Alliance project, to develop an open alternative to Passport.

All this may sound like business as usual, but at stake is nothing less than how the digital world of tomorrow will be organised. If web services take off, they will form a giant array of electronic offerings that will permeate every aspect of modern life. Which is why these offerings should ideally be based on open standards, rather than on the dictatorship, however benevolent, of a single company.

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Face value

A Turkish Rupert Murdoch

Feb 14th 2002
From The Economist print edition

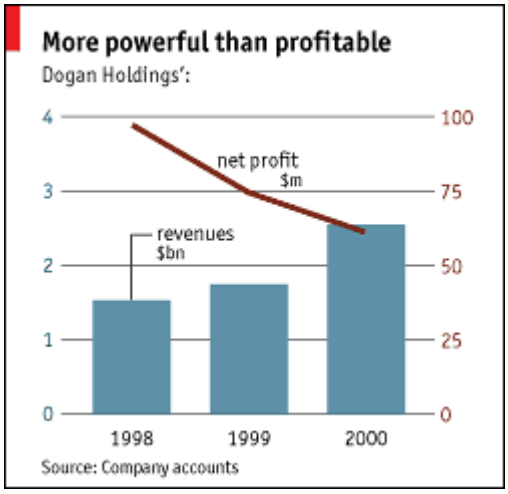
Aydin Dogan is one of Turkey's most formidable—and controversial—businessmen

WHEN Necmettin Erbakan was sworn in as Turkey's first Islamist prime minister in 1996, he declared war on what he called the country's media cartel. A year later, he was forced out, amid accusations that he had sought to replace secular rule with an Islamist dictatorship. Turkey's anti-Islamist generals played the main role in ejecting Mr Erbakan from office. But Aydin Dogan, Turkey's leading media magnate, and the chief object of Mr Erbakan's ire, helped to accelerate his downfall through a sustained anti-Islamist campaign in his newspapers and television channels.

Few people who have crossed swords with Mr Dogan have survived unscathed. Consider Sadettin Tantan, a former interior minister who campaigned against corruption. Shortly after he dared to suggest, last March, that Disbank, a financial institution owned by Mr Dogan, may have been tainted by irregularities, Mr Tantan was forced to resign. Or there is Nazli Ilicak, a former member of parliament who wanted to probe claims that Mr Dogan was exploiting his media muscle to bully governments into extending him commercial favours. She was banned from politics last June on charges—widely echoed in Mr Dogan's newspapers—of promoting anti-secularism.

The 65-year-old Mr Dogan is undeniably one of Turkey's most powerful and controversial figures. His empire has an annual turnover of $2.5 billion and spans eight newspapers (which rake in 66% of Turkey's print-advertising revenues), a petrol-distribution chain, tourism, banking, insurance and the music industry. His companies are among the most professionally run in the country and have attracted foreign partners that include AOL Time Warner, the *Financial Times* and Western Union. Yet Mr Dogan continues to be dogged by allegations that he bends the law and that his media empire, which also boasts two national television stations, has ballooned into a near-monopoly, with the potential to undermine Turkey's wobbly democracy.

His zealous backing of some proposed amendments to Turkey's media laws has encouraged such suspicions. Under the proposals, media owners would be permitted to control more than today's fixed 20% shareholding ceiling in TV channels, and would also be able to bid more easily in state tenders. “What about Rupert Murdoch, what about [Silvio] Berlusconi? Don't they do business with the governments?” retorts Mr Dogan when criticised over these changes. He has threatened repeatedly to hang himself in Istanbul's Taksim Square if any of the allegations against him are substantiated.



It is a measure of his influence that Turkey's parliament approved the new media law earlier this year, despite stiff popular opposition. It has since been vetoed by the president, Ahmet Necdet Sezer, a former judge, who said it violated the constitution. But parliament, which has the final say, could yet bring the new law back on to its agenda.

A self-confessed cowboy

Mr Dogan's entry into the media world was largely accidental. The son of a left-wing mayor in the town of Kelkit, a provincial backwater in eastern Turkey, his early dreams were of running the family farm, “sort of like a Texan cowboy”. But he caught the business bug after setting up a car dealership while he was still at an Istanbul college. By his early 20s he had made his first million as a distributor of Ford trucks.

He bought his first newspaper, *Milliyet*, a quality daily, in 1979 after it was offered to him over dinner by its then owner, Ercument Karacan, for $30m. Journalists who work under him describe Mr Dogan as a modest and kind-hearted man with strong family values, who shares canteen meals with them and never interferes in editorial policy. “I am sometimes outraged by the stories my papers print,” he says.

Today, Mr Dogan's liberal daily, *Radikal*, is the only serious broadsheet that systematically exposes human-rights abuses by Turkey's security forces and corruption among its politicians. He is also the only newspaper owner in the country to have an “ethics board”.

For more than a year Mr Dogan has been giving newsprint and cash for salaries to *Sabah*, a newspaper owned by Dinc Bilgin, his erstwhile arch-rival, who was released from prison last week after serving time for defrauding his own Eti Bank. Mr Dogan says he is acting out of professional solidarity. More likely, say his detractors, he is keeping *Sabah* afloat in order to stop other, more serious rivals from taking over what remains Turkey's second-largest circulation daily. The market leader, *Hurriyet*, became part of Mr Dogan's stable in 1994. It was at that point, his critics claim, that he became aware of his own power and began to abuse his political links.

Mr Dogan's cosy relations with scandal-spattered ruling politicians, such as Mesut Yilmaz, the deputy prime minister, remain the object of much controversy, however much he downplays them. So too is his ownership of the country's largest newspaper-distribution network. It has been fined by Turkey's competition authority following complaints from Mr Dogan's chief competitor, the equally controversial Uzan group, that it refused to distribute *Star*, a tabloid that is part of the Uzans' stable.

If anything unsettles Mr Dogan, it is not allegations of corruption or anti-competitive behaviour, but the economy. Like most Turkish companies, the Dogan group's biggest worry today is how to weather a crippling recession that shrank the economy by nearly 10% last year. Mr Dogan says that his newspapers have laid off at least 1,000 workers so far, but that his losses are tolerable. Asked if Turkey's government, led by Bulent Ecevit, can sort out the country's woes, he pauses briefly, before saying that he sees no alternative. Mr Ecevit and his ministers, it would seem, are safe for the time being.

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Financial regulation in America

Pitt the gamekeeper

Feb 14th 2002 | NEW YORK
From The Economist print edition

America's top financial-markets regulator, Harvey Pitt, stands accused of being a soft touch. Not yet proven

Get article background

Reuters

AMERICANS boast that their capital markets are the best in the world. Enron's collapse might suggest a confusion of quantity with quality. Misleading accounting, analysts who cheerlead for companies rather than analyse them, and more: are America's markets really more transparent, and its investors better protected, than elsewhere?

If they are, they need to be more so. And, as the chairman of the Securities and Exchange Commission (SEC), Harvey Pitt has the responsibility for making the improvements. When he was nominated last May, questions were raised over his suitability. Could a lawyer who had represented some of Wall Street's greatest poachers—and who had often challenged the SEC in court—really prove a good gamekeeper? The fall of Enron, and its implications for regulation, multiplied the doubts. Mr Pitt had often represented the big five accounting firms, and he opposed the ban on auditors selling consulting services to clients that was sought by his predecessor at the SEC, Arthur Levitt.

Mr Pitt plans to confound his doubters by proving that detailed knowledge of the law makes him an ideal guardian of it. The Enron debacle, far from being a source of embarrassment, he says, has become “the poster-child for the agenda I had already laid out.” Perhaps. Enron's collapse has certainly forced him to lay out his agenda sooner than he planned. He is now even ready to support a ban on auditors selling non-audit services “if Congress decides that is necessary”. It probably will.

On February 13th the SEC proposed several changes to corporate-disclosure rules. Firms will immediately have to reveal transactions in company shares by executives, rather than waiting up to 45 days. Annual results must be posted within 60 days, not 90 days, as now, and quarterly results must be published within 30 rather than 45 days. Material changes to a firm's business prospects—anything from waivers of corporate-ethics rules for employees, to the loss of a large customer—must be disclosed at once.

Firms will also have to explain why they have chosen particular accounting treatments, and show how the numbers would have looked on different assumptions. The SEC has written to the New York Stock Exchange (NYSE) and Nasdaq, asking them to show how listing requirements could be used to force companies to strengthen audit committees and otherwise improve corporate governance. Within a couple of months, Mr Pitt plans to publish proposals for a system for regulating auditors, based on a private-sector body “aggressively overseen” by the SEC.

He also intends to force an agenda for greatly improving accounting standards on the Financial Accounting Standards Board (FASB). Here, previous SEC chairmen largely failed—often thanks to lobbying by accountants represented by Mr Pitt.

One of Mr Levitt's proudest achievements was regulation FD (for fair disclosure), which required firms to disclose material information to all investors at the same time, instead of favouring professional investors. Though promising that there will be prosecutions, Mr Pitt thinks that regulation FD falls short, because it allows firms to “tell everything to everybody, or nothing to anybody”. He wants to impose a “positive obligation” on companies to disclose material information as it occurs—and in plain English, not

legalese.

Mr Pitt already claims success on the thorny issue of Wall Street analysts and their conflicts of interest. Guidelines published last week, in conjunction with the National Association of Securities Dealers, would restrict share ownership by analysts, make them explain their rating systems and disclose prominently any investment-banking relationship their firm has with the company being touted. Does this go far enough?

The chairman promises more “real-time enforcement”, including freezing the assets of likely villains so that there is money left for the victims. This year the commission has obtained two dozen court orders freezing assets, sharply up on previous years.

The SEC also wants to lay out a framework for competition among stockmarkets. Electronic trading systems threaten to fragment America's markets, making them less liquid. The SEC has been unsure over what to do. Mr Pitt says he wants as much competition as possible. He is exploring giving European exchanges more access to American investors. He says he will soon rule on applications by Nasdaq and Island, another electronic network, to be regulated as exchanges. The New York exchange, which stands to lose business, is lobbying against.

Raising capital effectively is another issue. Selling securities to the public is costly and slow, leading many firms to opt for private sales. That way, the public is denied plenty of decent investments, which end up only with sophisticated investors. Mr Pitt wants to integrate the SEC's disclosure regime with the system for raising capital, to make it easier for firms with good disclosure to raise fresh capital in the public markets.

As for the quality of investment advice, America's different securities laws treat types of professional advisers differently, even when they offer products and strategies that are more or less the same. Mr Pitt may try to harmonise the regulation of mutual funds, hedge funds, financial advisers and brokers.

Why does he think he can achieve so ambitious an agenda, when previous chairmen struggled? First, he thinks he can move faster by working with the private sector, not against it. Since September's terrorist attacks, and particularly after Enron's implosion, Mr Pitt claims, industry and regulators have worked together on reforms. Will everybody be so accommodating when there is less sense of crisis?

Second, the chairman thinks the commission can carry out its entire agenda without new legislation. In the 1990s the Federal Reserve used its own powers to undo much of the Glass-Steagall law that kept commercial banks out of investment banking. Similarly, Mr Pitt thinks he can transform market oversight by using the SEC's right to exempt firms and individuals from old regulations, giving the SEC wide freedoms to set whatever new rules it wants. He argues that broad exemptive authority was given by Congress to the SEC in 1996, but has never been used. The powerful interests at stake will no doubt challenge the commission's authority in court. At least the SEC should not be short of a good securities lawyer.

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Foreign-exchange losses

The ogre returns

Feb 14th 2002 | NO DATE
From The Economist print edition

Did an Irish bank ignore signs of wild trading in America?

THE rogue trader is alive and well—and living in Baltimore. John Rusnak, a dealer at Allfirst Bank, a subsidiary of Allied Irish Banks (AIB), appeared last week to have lost his firm $750m through trading foreign-exchange derivatives. He is sitting at home, helping six different investigations, among them probes by the Federal Reserve and the Central Bank of Ireland, to unravel exactly what went wrong. Eugene Ludwig, a former Comptroller of the Currency, investigating on behalf of AIB, is expected to report his findings within a month.

Most managers of financial risk had begun to see the rogue trader as an endangered species. A ranking of perceived banking threats, by the Centre for the Study of Financial Innovation in London, had put him 24th this year; in 1996, the year after Nick Leeson's trading in derivatives brought down Baring Brothers, the rogue trader was fourth. Mr Leeson was trading equity futures in a small foreign outpost of the bank. He was able to interfere with the reporting of trades to create fictitious positions. AIB suspects fictitious trades in Mr Rusnak's case, in the Baltimore outpost, possibly with collusion inside or outside Allfirst Bank.

Bank chiefs everywhere hauled in their risk controllers this week for reassurance that no such fiasco could visit their banks. In most cases, such a chain of events seems inconceivable now that the controls have been designed, since Baring's collapse, to catch errors or fraud at every stage. Losses amounting to $750m by a trader who was authorised to risk positions of only a few million dollars would normally be spotted within days of breaching his limits. Large trades would show up in confirmations from the trading counterparty. Cash would be needed to finance losses, or to pay premiums on option contracts.

What went wrong at AIB? The bank itself has little to say, for now. One factor may have been the compactness of the operation, with little physical distance between traders, middle office and back office. Initial reports referred to genuine spot and forward foreign-exchange contracts, in dollars against yen, apparently hedged by options—some real, some fictitious. Allfirst officials were alerted to problems some weeks ago by unusual demands for cash to cover the positions, according to Michael Buckley, AIB's chief executive. Why not earlier?

Allfirst's annual filing last March to the Securities and Exchange Commission shows that the bank had foreign-exchange forward and option positions at the end of 2000 with a fair value of $224m. (This is what the bank estimates it would have obtained had it sold those positions for cash that day.) It is a large amount, about a third of all the AIB group's off-balance-sheet positions in foreign exchange, and bigger than any other derivatives position that Allfirst was carrying.

It is not clear how much of the gain was offset by option premiums paid out, or by foreign-exchange positions on the balance sheet. However, since it was money owed to the bank by counterparties, it should also have shown up as a credit exposure. And since it was a leveraged position, it was volatile, able to fluctuate by a large amount each day.

Even this appears not to have prompted risk controllers, either at Allfirst or at AIB, to investigate Mr Rusnak's operation. Central Bank of Ireland officials made a routine inspection of Allfirst in May 2001, presumably with the SEC report in their hands. Their main concern, says a central-bank spokesman, is the overall health of the AIB group. If the fair-value figure had been as big in a negative direction, alarm bells would surely have rung. But, as in Mr Leeson's case, risk managers may have ignored one of the essential principles of their trade: suspect big gains as much as big losses.

Given this cushion of reported gains at the end of 2000—whether real or fictitious—it may have been

easier for Mr Rusnak to play with his options book without too much scrutiny from on high. Whatever the findings, expect the rogue trader to be higher up the list of ogres next year.

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The economics of envy

Rich-bashing

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From The Economist print edition

Economists chance upon irrational behaviour

ADAM SMITH famously argued that an invisible hand of self-interest guides markets to beneficial results. Today, rational and unemotional agents, rather than altruistic angels or envious demons, lie at the centre of most equation-choked economic theories. But a new paper, “Are People Willing to Pay to Reduce Others' Incomes?”, in the February issue of *Annales d'Economie et de Statistique*, suggests that Smith should have paid more heed to another hand: the one that cuts down tall poppies.

Daniel Zizzo of Oxford University and Andrew Oswald of Warwick University crafted a series of experiments in which groups of four people were given nearly equal sums of money. The four had to gamble with their new wealth in random, computerised bets; two came out each time with more cash, and two with less. Richer or poorer, each was then given the chance to spend his money to reduce the take of his fellow subjects. There was no prospect that this would make him any richer. Indeed, it would cost him anywhere from two to 25 cents for every dollar destroyed that belonged to his fellow players.

Economic man would surely never spend his money merely to hurt others, while leaving himself poorer? The professors were shocked to find that even at the price of 25 cents for every dollar burnt, 62% of the participants paid for the privilege of impoverishing their peers. What accounts for this?

One answer could be the players' sense of fairness. Another, of course, could be envy or *Schadenfreude*. The poor souls who lose some of their initial wealth like to burn the undeserving who receive a lot. No surprise to novelists. But the idea that man is a social animal, more concerned with relative rank and status than with absolute well-being, sits awkwardly with economics.

Even the rich winners in the experiment like to see others taken down a peg: they destroy the wealth of rich and poor alike. The authors speculate that the plutocrats expect the plebeians, out of jealousy, to destroy their wealth. Pre-emptive retaliation preserves their rank. Nothing irrational about that.

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Credit-rating agencies

Quant argue with that

Feb 14th 2002 | NEW YORK
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Rating agencies defend their style of analysis—and hedge their bets

THE two credit-rating agencies that dominate the business come in for flak from all sides. Investors caught holding Enron's investment-grade bonds as their price sank to below that of junk say that Moody's and Standard & Poor's (S&P) are just too slow to spot companies' declining financial health. Equally, say others, they are just too fast when they produce unjustifiably large changes in ratings. Stung by a precipitous downgrade, Tyco, once a high-flying American conglomerate, has had to seek an emergency and very costly refinancing, punishing investors.

The agencies use legions of highly trained analysts with access to top management. Their meticulous reports giving ratings for corporate bonds are designed to give an accurate picture of the bonds' riskiness and, ultimately, the probability of default. Lately, rating agencies have struggled to keep up; it seems a bond's rating tells you ever less about the price that investors are willing to pay. In 1997 two-thirds of debt rated triple-B by S&P was priced within 20 basis points (hundredths of a percentage point) of the average bond with the same rating. Since then, the range has widened. Last year credit spreads' standard deviation, a measure of dispersion, had risen more than sixfold.

A related criticism is that old-fashioned ratings imperfectly measure the probability of default. KMV, a credit-research firm from California, uses sophisticated quantitative analysis—in particular, statistical modelling of a company's share price—to impute default probability. Tim Kasta of KMV says that the firm's recent study of 320-odd bonds, rated by the agencies as being just above junk, shows that half of them should have had higher, or lower, ratings than they were given, if the prospects of default in the year ahead had been accurately reflected. Another of the firm's studies claims that “literally no information” in the debt ratings calculated by Moody's and S&P was not already contained within KMV's own modelling.

The agencies offer two broad sets of defences, one rhetorical, the other practical. They argue that widening price ranges for bonds are a result of increased economic and financial stress—hardly the agencies' fault. Besides, they say, ratings are intended to look at the likelihood of default for a period far longer than a year, and here they have done a good job. Martin Fridson, head of high-yield research at Merrill Lynch, argues that S&P's statements on the outlook for the ratings on industry groups are valuable leading indicators for the direction of bond prices. There is also good reason for a rating to diverge from a market price. In the case of Enron, the agencies made clear they would continue to give an investment-grade rating to the firm only if it was acquired by a rival, Dynegy. When that deal collapsed, so did the rating.

The practical defence is to acquire the quants. In 1995 Moody's set up its in-house version of the kind of work done by KMV. Standard & Poor's did likewise, and established relationships with a number of small companies working in the area. On February 11th Moody's announced that it would buy KMV, with fewer than 200 clients, for $210m.

KMV, founded in 1989, is not without critics of its own. Companies on the receiving end of a critical evaluation are left little the wiser; a lengthy explanation follows a traditional downgrade. What is more, companies resent having their bonds subjected to, as they see it, the same stockmarket whims that cause havoc with their share price. Portfolio managers sympathise. Even though the head of Vanguard's bond operation, Ian MacKinnon, uses KMV and its like, he points out that share-price movements contain “so much more than default risk”. It is not always easy or even possible to extract signals about default risk from all the other noise.

If rating agencies are often accused of being too slow to reflect bonds' changing risks, KMV's evaluation

can change daily. Quick shifts may correspond to changes in a company's solvency, and for some participants in the credit markets, notably traders, fast changes are the source of profits. But for banks and borrowers who cannot rework credit agreements overnight, volatility on this scale is a nightmare.

Both Moody's and Standard & Poor's are considering whether to incorporate information generated by financial markets into their analysis. Yet they are concerned that the result could prove destabilising, as the market and the agencies reinforce each other's evaluations, losing sight of the fundamental state of the company being analysed. On the same day that it announced its acquisition of KMV, Moody's put out a defence of its core rating process. Market opinion, typically, was “extraneous to the analysis of the issuer's fundamental creditworthiness.” Whoever made the acquisition, it seems, had a different idea.

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French banks and money-laundering

Operation screw the banks

Feb 14th 2002 | PARIS
From The Economist print edition

French bankers are forced to take money-laundering seriously

PARISIAN bankers are in a state of unease. An investigating magistrate, Isabelle Prévost-Desprez, has so far placed top executives from eight French banks under investigation for *blanchiment aggravé*, serious money-laundering. Daniel Bouton, the chairman of Société Générale, France's third-largest bank, and his deputy, Philippe Citerne, were the latest to be taken in for questioning. Ms Prévost-Desprez may well cast her net wider.

EPA

Prévost-Desprez draws a bead on bankers

The severity of the investigation, which centres around issues such as cheque controls rather than deliberate criminal activity, is overdone, say the banks. They believe themselves to be victims of the overweening power of France's investigating magistrates, who at one time or another have fingered executives from half the 40 companies in France's main share index. Bankers are indignant about the hours they have spent in jail, obliged to surrender shoelaces, belts and Hermès ties—anything that might conceivably be used to commit suicide.

It began in the Sentier district, home of the Paris rag trade, where a group of merchants pulled off an operation to defraud their banks. When the banks brought in the police in 1997, a bigger scam came to light. Stolen French cheques were being sent to Israel, signed over to new beneficiaries, cashed at money-changers and presented to Israeli banks for payment. The Israeli banks then sent them to be cleared by their correspondent banks in France.

To the dismay of the French banks, the investigation turned on them. Ms Prévost-Desprez, it seems, thinks that by failing to scrutinise the cheques, the banks facilitated crime. Last June French police asked for photocopies of cheques from Israel over a period of time. Ms Prévost-Desprez, say the banks, reckons that these requests were a clear signal to take extra care.

In response, Société Générale says that it cannot monitor all of the huge number of cheques it clears every day; most banks' cheque-clearing processes are automated. As for the signal, Société Générale protests that it receives over 10,000 similar requests from the police each year. Banque Leumi France, by contrast, a far smaller bank also under investigation, asserts that it did tighten its controls after receiving the police tip-off. It told its parent in Tel Aviv, Bank Leumi, not to send any more cheques from Israeli money-changers.

What will probably save the bankers is that, in order to prosecute a criminal charge of assisting money-

laundering, Ms Prévost-Desprez needs to show that they did it intentionally. Negligence alone does not constitute intention.

Even so, being whisked off without warning has focused the minds of senior French bankers. They are determined to get new laws on what exactly they must do to guard against money-laundering. The current stipulation of vigilance is neither defined nor practical, says Gilles Guitton, head of the banking association. As a start, he has asked the banking regulator to come up with guidance on cheque-clearing and correspondent banking.

In the meantime, Société Générale has stopped accepting cheques, for two months, from banks in Israel. Crédit Lyonnais, a bank that has not yet been *mis en examen* for money-laundering, even though it is being investigated in America and in France for other wrongdoings, has gone further. It will no longer accept cheques from any bank in the 19 countries on the blacklist of the OECD's Financial Action Task Force on money-laundering. The list includes Israel, Hungary, the Philippines and Russia. Other French banks have discreetly taken similar action.

Banks can expect more scrutiny of their correspondent-banking activities in future. Since the al-Qaeda network is believed to have made use of the system to move money, the need for greater supervision has leapt up the political agenda. The experience of the French banks points to the impossibility of knowing much about the customers of a correspondent bank, however apparently reputable.

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Russia's economy

Scratch and sniff

Feb 14th 2002 | MOSCOW
From The Economist print edition

Russia's economic recovery is more fragile than it seems

BY THE dismal standards of the past, it looks splendid. Russia's economy grew by a respectable 5% last year, the budget was balanced, inflation came down and the currency stayed steady. Big cities such as Moscow are visibly booming. There is a stable government, plugging away at needed reforms. Foreign interest is rising, and the main share index has more than doubled since the start of last year.

Good news for the band of financiers peddling Russian stocks and bonds for the past decade. With luck, share prices may even crawl back to where they were in the heady years before crisis, default and devaluation in 1998. Still, a bunch of worries remain.

One is that two temporary factors largely account for the recovery since 1998: a collapse in the value of the rouble and a tripling of the oil price. They brought a windfall to exporters, and gave local manufacturing companies a competitive boost. Because both bits of good fortune have now run out, the economy ground to a halt or even shrank in the fourth quarter of 2001, according to official estimates.

An unusually critical study by the World Bank highlights three problems. One is the failure to diversify. Christof Rühl, the report's author, argues that the Russian economy is overly dominated by large firms, mostly dealing in raw materials. This does not change, because of bureaucratic barriers faced by new businesses, and because no proper banks channel money from rich companies to deserving ones. Rather, spare money goes to chums in other bits of the same empire. Russia needs to emulate resource-rich countries, such as Australia and Norway, which have over time developed broader-based economies. Russia's main claim to future first-world status, its educated workers, counts for little if they do not find productive work.

That touches on the second big problem, low productivity growth. Russia's recovery from the post-Soviet output crunch, using under-employed workers and spare capacity, flattered these figures. Still, Mr Rühl believes that this phenomenon too has run its course. In future, higher productivity means either more investment or better organisation of work.

With isolated exceptions, there is little sign of that happening. This is all the more urgent, because Russian companies now face harsher constraints. Capital has a real cost. The prices of energy and other inputs are rising relentlessly. The tax regime is getting clearer and tougher.

To be fair, reformers in the government are aware of the problem. President Vladimir Putin himself has bewailed the shortage of small businesses—their numbers, according to official statistics, may even be dropping. On paper, recent and planned reforms look like a coherent attempt to create a clear, friendly environment for business. But there is a third problem: implementation.

Under Mr Putin, the political system has become more obedient, and laws whiz through parliament. The hitch is what happens then. Some simple changes, such as lower tax rates, do take effect. But greedy and incompetent bureaucrats are hard to change. One new law limits the number of inspections (by health, hygiene, fire-safety and other officials) that a business may endure. The joke is that, instead of scores of inspections every year, managers will in future have only two—and each will go on for six months.

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America's current-account deficit

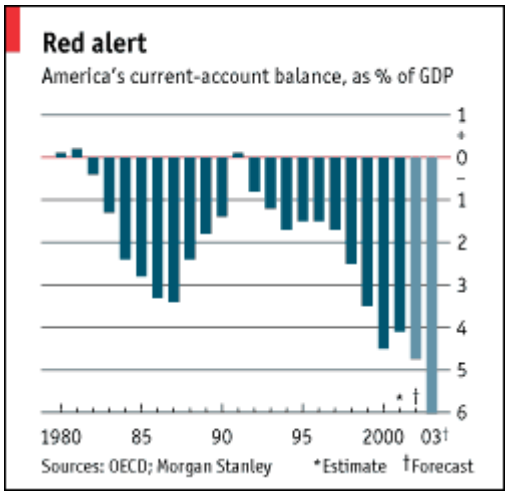
Wanted: $2 billion a day

Feb 14th 2002
From The Economist print edition

America's external deficit cannot keep growing forever

WARNINGS that America's current-account deficit is unsustainable have sounded for years, nay decades, like a stuck gramophone record. In recent years, foreigners have more than financed the gap by buying dollar assets. Yet what is unusual now is that America's deficit has barely been dented by the recession. An economic rebound could therefore swell the deficit to levels at which the warnings at last come true.

In previous recessions, such as the early 1980s and the early 1990s, the current-account deficit moved back into rough balance. As domestic demand slowed, imports fell, while exports continued to grow. Not this time. Last year, even though America moved into recession, the deficit is estimated to have stayed above 4% of GDP (see chart).



This has been an unusually synchronised global recession. When America went into recession in 1990-91, Japan and most of Europe continued to flourish, buying lots of American exports. By contrast, exports of goods and services in the fourth quarter of 2001 fell at an annual rate of 12% in real terms, while imports fell by only 3%. Exports have also been squeezed by the strong dollar, which since 1995 has risen in trade-weighted terms by two-fifths. Meanwhile, American consumers kept spending, sucking in imports last year.

America now imports half as much again as it exports. So even if imports and exports grow at the same pace, the current-account deficit will widen in dollar terms. If the American economy rebounds fairly swiftly, as most economists forecast, imports will continue to outpace exports. Stephen Roach, chief economist at Morgan Stanley, forecasts that in 2003 the deficit could reach a record 6% of GDP.

Not only would that be the biggest deficit run by a G7 economy in the past 30 years, it also implies that America would need to raise from abroad an annual $660 billion, or $2 billion a day. America's net foreign liabilities now amount to almost $2.5 trillion, equivalent to 25% of GDP.

Large current-account deficits cannot persist forever. If capital inflows dry up, the deficit has to shrink, either through a fall in the exchange rate, or through a demand-crimping recession, or both. But when? A study by Caroline Freund, at the Federal Reserve, looked at 25 episodes in developed economies of large adjustments in the current-account deficit. It found that deficits usually began to reverse when they exceeded 5% of GDP. Such adjustments were typically accompanied by a 10-20% fall in the real exchange rate. According to Mr Roach, the United States will breach the 5% limit by the end of this year.

What might cause foreigners to dump dollar assets? Some economists think that a full-blown crisis in Japan's financial system would force Japanese financial institutions to repatriate large amounts of their overseas funds, especially American Treasury bonds. Something like this happened when Japan's banking system wobbled in 1998. Intriguingly, Japanese investors sold a net ¥3.1 trillion ($24 billion) worth of foreign bonds last month, the largest monthly net selling in four years.

More likely, if confidence in Japan's banks continues to sink, Japanese savers will flee yen assets, pushing the dollar—and America's current-account deficit—even higher. For the deficit, that just stores up bigger trouble for the future.

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Economics focus

Tax or trade

Feb 14th 2002
From The Economist print edition

A novel approach to tackling climate change could satisfy economists and environmentalists alike

Get article background

WHAT should America's policy on climate change look like? As *The Economist* went to press, George Bush was delivering his answer (see article). When he rejected the UN's Kyoto Protocol as "fatally flawed" last year, he insisted that he regarded the problem as real, and promised a credible domestic alternative. Unfortunately, his proposal does not include either of the two things that would commend it as a serious effort: taxes on carbon emissions, or mandatory limits on them.

In principle, taxes and targets are equally efficient ways to reduce a given pollutant, although, as *The Economist* has long argued, the tax approach has the advantage of simplicity. An economy-wide carbon tax could be implemented with little of the red tape likely to surround a regulatory approach. It would send a powerful signal to all parts of the economy, unlike measures aimed only, say, at power plants. However, as Bill Clinton discovered in the early 1990s, energy taxes do not get far in Congress.

That is one reason why most American environmentalists prefer the second approach: binding targets for greenhouse-gas emissions. Once, this method might have precluded the economic flexibility of a tax—namely, that the abatement effort can vary from polluter to polluter, according to cost. Nowadays, though, even many green groups acknowledge that such flexibility makes sense, and that you can duplicate it in a target regime by issuing tradable emissions permits.

Under this approach, the government would cap total emissions and give firms allowances, by auction or grant. Since firms must pay a price if they exceed their allowances, they have an incentive to cut emissions. Since the permits are tradable, those with low marginal costs of abatement will make extra cuts and sell credits to firms that find it more costly to cut emissions.

The result is a target achieved at least cost, both to firms and to the whole economy. This is no free-market fantasy: America's scheme to trade sulphur dioxide emissions, in order to reduce acid rain, has done better than its initial target, at less than half the anticipated cost. Various proposals in Washington, DC, now suggest some form of "cap-and-trade" regime for carbon. The Congressional Budget Office has produced a good review* of the leading contenders.

One interesting proposal† comes from Resources for the Future (RFF), an American think-tank. The theoretical notion that price instruments (carbon taxes) and quantity instruments (emissions targets) are equivalent, RFF researchers argue, is true only if the costs and benefits of reducing emissions are pretty certain. In the case of greenhouse gases, that is not the case: estimates of both vary enormously. A rigid target runs a risk, however small, of imposing ruinous costs. This could be true even with cap-and-trade.

This looks like another reason why a carbon tax is better. But RFF makes the case for a hybrid: combine cap-and-trade with a "safety valve". The environmental discipline of the rigid target would prevail, unless the cost of meeting it rose sharply, to an agreed trigger price. If that happened, the straitjacket would be loosened, and extra permits would be sold until the end of the compliance period. This proposal suggests an initial trigger of $25 per tonne of carbon (adding six cents a gallon to the price of petrol); others would set it much higher. The key is that the level should rise gradually over time, encouraging individuals and companies to prepare for a low-carbon world.

Most American conservatives hate this idea. They call it a carbon tax by stealth—and since a carbon tax

is a tax, it must be bad. Once the safety valve is triggered, they are right that the system works like a tax—but so what? (It need not be a tax rise in the aggregate, obviously: the revenues could be used to finance income-tax cuts.) Most greens, even those sympathetic to market approaches, are equally ferocious in their opposition. Their chief worry is that “environmental integrity” will be compromised—that is, the emissions target might not be achieved with certainty.

They are right—but, again, so what? If the cost of achieving the target turns out to be painfully high, then popular opinion would anyway doom their ambitions to failure. If abatement costs are high, this scheme still delivers the green goals of a cap-and-trade scheme until the safety valve is hit. If the costs are low (as many greens predict), the safety valve will never actually be triggered.

Economists at MIT** point out that a cap-and-trade regime might be designed to do what the safety valve does without sacrificing fixed targets. They point to “banking” provisions that let firms borrow or store allowances from adjacent compliance periods as an equivalent method. The RFF researchers reply that, for greenhouse-gas banking to work well, firms must bank lots of credits—and that raises the chances that dubious ones slip through.

The RFF approach seems best. It forces politicians to say what price society should be willing to pay to address global warming—and offers a pragmatic way to make that cost explicit.

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* “An Evaluation of Cap-and-Trade Programs for Reduction of US Carbon Emissions”, by Terry Dinan, et al. Congressional Budget Office, June 2001.

† “Reducing Carbon Emissions and Limiting Costs”, by Richard Morgenstern, et al. Resources for the Future, January 2002.

** “The Safety Valve and Climate Policy”, by Henry Jacoby and Denny Ellerman. MIT Joint Program Report #83, February 2002.

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Unnatural life

And now for something completely different

Feb 14th 2002
From The Economist print edition

Chemists are trying to synthesise new varieties of life

"THE constraints of the genetic code are history," proclaims Peter Schultz, of the Scripps Research Institute in La Jolla, California. Then, with a touch of modesty creeping into his tone, he adds, as a bit of a fig-leaf: "At least in bacteria, the genetic constraints that we have had to cope with for the last few billion years are gone."

Dr Schultz's statement is no idle boast. For years, biologists have been tinkering with life's tangled web of genes and proteins by tweaking a molecule here, deleting one there and seeing what followed. By contrast, Dr Schultz's laboratory, along with another team of chemists based in Japan, are introducing completely new strands to these webs. If successful, they will fabricate what could reasonably be described as a new sort of living thing.

Pure artifice

To do this, they are tinkering with the way that cells produce proteins from DNA. Each DNA molecule consists of two chains of chemical "letters" that twist around one another in the famous double helix. In nature, there are four sorts of letter (known, technically, as bases). The chains are held together because the bases (called A, C, G and T) like to pair up. But they are fussy about their partners: A pairs only with T, and G with C. One chain can thus be used as a template to construct its partner.

When read off in threes (genetic "words" known as codons), the letters in DNA can be translated into amino acids, the chemical building blocks of which protein chains are composed. Of the 64 possible codons, 61 correspond to particular amino acids—though several amino acids have more than one codon, since natural proteins consist of only 20 sorts of amino acid. The other three codons are signals to stop making the chain.

The protein-making machinery does not read the DNA directly. Instead, it reads copies, known as messenger RNA (mRNA), that are produced in large quantities from the original DNA blueprints—the genes—for particular proteins that a cell needs to produce at a particular time.

The final part of the process involves a second sort of RNA, known as transfer RNA (tRNA). Each variety of tRNA has an "anticodon" that complements one of the codons found on mRNA. It also has a part that likes to bind chemically to the appropriate amino acid. The tRNAs are matched, one by one, to the codons of the mRNA in a piece of cellular machinery called a ribosome, and their amino-acid cargoes are added to the growing protein chain.

This is where Ichiro Hirao, Shigeyuki Yokoyama and their colleagues at the Yokoyama Cytologic Project in Saitama, Japan, come in. They have developed unnatural versions of all the ingredients in this process: the bases, the DNA, the RNAs and the amino acids. The result is a protein that could never have existed in nature.

As they report in this month's *Nature Biotechnology*, they began their experiment by constructing a pair of new bases, dubbed S and Y. These combine in the same way as A and T or G and C, so they can fit into DNA molecules without disrupting them.

They then patched an artificial codon containing S into the gene for a protein called Ras, and created a tRNA that had an anticodon for this unnatural triplet, together with a binding part for an amino acid that is not one of the usual 20. When they mixed their artificial biochemicals (including the unnatural amino acid) with a bacterial extract that contained ribosomes and all the appropriate enzymes, Dr Hirao and Dr Yokoyama found that the unnatural additions were treated just like their natural analogues. The result was a version of Ras that sported the new amino acid at the appropriate position, proving that the invented codon, artificial base and all, had been recognised and used.

This is, of course, a preliminary result (though Dr Hirao and Dr Yokoyama report that they can insert more than one of these unnatural S-Y pairs into a single gene). But if the new S-Y pair turns out to work as well as the two existing ones, the capacity of the genetic code would more than triple. The new bases mean that there would be 216 possible codons—in other words, 152 entirely new codons up for grabs. Each of these could be linked to a new, unnatural amino acid, which could then be slipped into living cells and incorporated into never-before-seen proteins.

Before that could happen in a useful way, however, cells would have to be given the machinery to make the ingredients themselves, rather than being spoon-fed them, as Dr Hirao and Dr Yokoyama have done. Dr Schultz and Lei Wang, a researcher at Scripps who works with him, have made progress down this path.

They use a different strategy from the Japanese. Rather than inventing a new base pair, they have co-opted the least common of the three stop codons and used it to code for various new amino acids. They have done this by creating versions of tRNA that have an anticodon matching the stop codon, and also sport unnatural amino acids at the other end.

When they published their first results, ten months ago, they had successfully added one unnatural amino acid to a bacterial protein. They have now repeated the feat ten times, and thus have 11 strains of bacteria that each possess 21 amino acids. Until recently, they have had to feed their bacteria with the unnatural amino acid in question, but in one case they have managed to overcome even that constraint. By patching in a plant gene, they have created a mutant strain that can make an enzyme which converts a natural amino acid called tyrosine into one of the synthetic forms. According to Dr Wang, this approach could be used to create strains of bacteria capable of producing whole hosts of odd amino acids.

Mother Unnature's power

Augmenting proteins with unnatural amino acids could make existing proteins more potent in their actions, or even endow them with entirely new properties that might be useful for industry or medicine. Dr Schultz's bacteria, for example, look and act entirely like normal creatures until they are placed in contact with a certain sort of poison. Then, because they are producing an unnatural protein, they survive while all the others die.

These new varieties of living thing could also shed light on an old and vexed scientific question: is the fact that all cells seem to work on the same 64-codon, 20-amino-acid system an historical accident, or does it represent some sort of optimum? Dr Schultz's unnatural bacteria could help to answer this. By exposing natural and unnatural bacteria to the sort of conditions believed to have prevailed on the early earth, when life's chemical tool kit was being assembled, and letting them fight for survival, it might be possible to observe whether bacteria with 21, 22 or even more amino acids might win out over those with the standard complement. That information would help biologists to understand whether life could have evolved substantially differently from the way that it actually did.

Back in the present, the next order of business is to apply the research to mammals. Dr Wang says that a certain strain of monkey cells has shown a promising tendency to incorporate unnatural amino acids. Within a year, he thinks, the group should have made mammalian cells equipped with 21 amino acids. “Ultimately, we would like to make a mouse”, says Dr Schultz, “and quite frankly, we are likely to make a mouse within two to three years.” If he succeeds, says an admiring colleague at Yale, “he will either win a Nobel prize or be thrown in jail.” Whether he wins applause or opprobrium, though, one question still remains, to which even Dr Schultz does not yet have the answer: if the constraints of the genetic code are indeed history, what constraints remain?

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Particle physics

Radioactive disputes

Feb 14th 2002
From The Economist print edition

A potentially Nobel-prize winning discovery. Or maybe not

IF IT proves true, remember that you read it here first. Hans Klapdor-Kleingrothaus and his colleagues at the Max Planck Institute for Nuclear Physics in Heidelberg have just reported the first recorded instance of neutrinoless double beta decay.

That might not sound like news worth holding the front page for, but to those interested in fundamental physics, it is. If it turns out to be correct, it will require a substantial rewriting of the Standard Model, the current repository of all knowledge and wisdom about particle physics.

In normal beta decay, one of the neutrons in an unstable atomic nucleus turns into a proton, prompting the emission of two particles: an electron and an anti-neutrino. This fits with the Standard Model, which says that a fundamental quantity of the universe, called lepton number, must be conserved. Electrons and neutrinos have a lepton number of +1; their anti-matter counterparts, positrons and anti-neutrinos have a lepton number of -1. The result is that the net change of lepton number in beta decay is +1-1, in other words, zero.

There is a very small chance, however, that two neutrons will decay at the same time, resulting in the simultaneous emission of two electrons. That, according to a heretical theory, might occur without the emission of any anti-neutrinos at all, which would violate the conservation of lepton number and put the Standard Model in trouble. Such a neutrinoless double beta decay could, according to the theory, be detected by monitoring the energy of the electrons given off.

Dr Klapdor-Kleingrothaus and his colleagues looked for the tell-tale signal in ten years' worth of data collected from a radioactive-decay experiment being carried out at a laboratory inside Gran Sasso, a mountain in central Italy. In a paper in *Modern Physics A*, they say they have found it.

If they have, the result would not only violate the conservation of lepton number, it would also mean that anti-neutrinos and neutrinos are actually the same thing; in other words a neutrino is its own antiparticle. It would also have cosmological consequences, since it would make neutrinos into objects a lot more massive than is currently believed. Since neutrinos are extremely abundant, that would go some way towards explaining the so-called exotic dark matter in the universe, which observation shows is there, but is not made of ordinary atoms.

Not surprisingly, the announcement has provoked a backlash. An international group of researchers has written a letter to *Modern Physics A*, arguing that Dr Klapdor-Kleingrothaus has been selective in his analysis, and that the data do not show the result he claims. Whether that result is indeed a lemon, or the letter proves to be sour grapes, remains to be seen.

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Optical communications

Cutting the cable

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"Free-space" optics requires no fibre. That may be an advantage

FIBRE optics revolutionised communication by abolishing the law that light can travel only in a straight line. From that point on, light signals could be treated in the same way as electrical ones, and bent round corners. Some people, however, are never satisfied. And these dissatisfied engineers are trying to turn the clock back by developing systems that use "free-space" optics—in other words sending information from place to place by shining laser beams through the air.

Free-space optics has three advantages. It is easy to install. It can handle a technology known as wavelength division multiplexing (WDM) without, as it were, blinking. And it seems suited to a new—and allegedly uncrackable—encryption technique called quantum key distribution.

Speed of installation comes from not having to dig up the road to lay conduits. Free-space optics may thus be an answer to the difficulty of providing broadband connections to customers' homes and offices—the so-called "last mile". Free-space links that operate at speeds of up to 20 gigabits a second—as good as fibre—have now been demonstrated. They can be installed in hours rather than the weeks or months normally needed for broadband access. And if they can be put into place quickly, they can be upgraded quickly, too.

That matters in the context of WDM, a technique that allows a single optical path to carry thousands of parallel channels, as long as each is encoded in a slightly different colour. Upgrading a fibre network for WDM is hard. First, individual fibres are each compatible with only a few WDM schemes. The exact chemical composition of a fibre's glass determines how transparent it is to different frequencies, and also its tendency to disperse those frequencies even when it is transparent. Both restrictions reduce the number of channels that can be carried. Moreover, even if a particular fibre can be used with a particular scheme, the light sources, amplifiers, switches and associated paraphernalia usually cannot. Amplifiers, for instance, will not boost all colours equally, so special devices are necessary to compensate.

Free-space optics suffers from none of these problems. Air is transparent to a wide range of frequencies and has few dispersive tendencies (at least, when the weather is good). And with the associated kit clustered together in base stations, upgrades are easy to carry out.

The third advantage—for quantum key distribution—is more speculative. The technique exploits the arcana of quantum mechanics to let two computers swap a cryptographic key (and thus the means to decode a message) with perfect security.

Quantum key distribution has been demonstrated successfully in fibres, but it suffers from one major drawback: it requires a dedicated link, and so cannot be implemented in a network. However, two experiments carried out in the past few weeks have shown that it works with free-space optics. First, researchers at QinetiQ, a British-government-owned company, and Ludwig Maximilian University, in Munich, Germany, exchanged keys between two alpine mountain-tops more than 23km apart, though they did so at night, when sunlight could not confuse the signal. Then, another group of researchers, from Los Alamos National Laboratory in New Mexico, announced that they had performed a 10km key exchange in broad daylight.

These two groups are working towards military applications in which the key is exchanged from the ground to a satellite. But both recognise that the technology might be exploited commercially, and are part of a European Union collaboration called QuComm that is encouraging this.

Free-space optics would have the odd drawback, such as flocks of birds, showers of snowflakes or banks

of fog interrupting the beams. But message-encoding systems are already set up to cope with lost data. Many customers might be willing to put up with a 99.999% available service that could be installed straight away, rather than waiting indefinitely for the 100% availability of fibre.

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A rat exchange

LaboRATory dealings

Feb 14th 2002
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Researchers can now order rats over the web

MEDICAL scientists struggling to track down rare kinds of rat for their research will soon be able to shop for a wide range of them as easily as if they were buying a book over the Internet. The Rat Resource and Research Centre (RRRC), a clearing-house for laboratory rats based at the University of Missouri, Columbia, will enable them to acquire the perfect animals for their experiments, using the World Wide Web. For those in a beneficent mood, the centre is also accepting donations.

Although they are not as ubiquitous as laboratory mice, lab rats sometimes have advantages (notably size) over their smaller cousins. They are used, in particular, for the study of such diseases as arthritis, obesity and Alzheimer's. But commercial rodent repositories tend to stock only the bestselling models; and the few existing non-commercial sources cannot handle the demand. Meanwhile, scientists who have managed to develop unusual strains generally lack the facilities to breed in bulk or to organise shipping to other interested parties. So, in 1999, America's National Institutes of Health (NIH) brought together a panel of rat scientists to find a solution. The RRRC, which cost the NIH $6.7m, was the result.

The centre is equipped to take ten new rat strains a year, with a maximum of 50 when it is full. Researchers who want to donate rats should pay a visit to www.radil.missouri.edu/rrrc and fill in an application form, giving details of the rat model's genetic composition and background. So far, the RRRC has accepted two rat strains, both designed for research into rheumatoid arthritis. But diversity is key to the operation, and John Critser and Lela Riley, the centre's directors, hope to add three different models to its rat-bank within the next six months.

The RRRC plans to start taking orders from customers by the summer, charging a nominal fee for its service to cover costs. Customers will be able to order their rats either alive and kicking or cryopreserved, according to taste, as the centre will specialise in freezing embryos, eggs and sperm in liquid nitrogen until they are needed for research. If selecting from a connoisseur's collection of rodent strains is not enough for the gourmet rat scientist, then being able to choose whether you want your rat chilled or at room temperature has surely got to be a selling-point.

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About sponsorship

Victor Hugo

An interrupted sentence

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The author of "Les Misérables" turns 200 on February 26th. We celebrate the colourful life of a great poet, novelist and political turncoat

VICTOR HUGO was born in 1802, and his bicentenary promises to be the biggest celebration of any writer in years. The French ministries of education and culture have set up enormous Hugo websites, listing enough Hugo-related events, from Madagascar to China, to last another 200 years. The education ministry's homepage shows a cartoon Hugo riding a globe, wielding a lyre and waving like a Gallic Mr Magoo. It urges schoolchildren to dive into the "man-ocean" of this universal writer. The culture homepage, meanwhile, shows a stretch of coast and a quotation from Hugo's "Tas de pierres": "Life is an interrupted sentence". It presents the bicentenary as a celebration of "the values on which our republic is founded".

This is a risky thing to say about a man who began as a court poet, became the ringleader of the young Romantics, cosied up to three monarchies and managed to be a hero to socialists at the same time. In 1848 Hugo stormed the barricades with government troops. Three years later he was on the other side, trying to stir up resistance against the *coup d'état* of Napoleon III. He fled on the night train to Brussels, disguised as a worker, and spent the next 19 years in exile, first on Jersey, then on Guernsey.

Hugo's inflammatory poems were smuggled out of the Channel Islands and inspired revolutionary movements around the world. The exiled poet was an embarrassing blot on the shiny Second Empire. The British government treated him as a diplomatic disaster and tried to send him to America. "The question now is", wrote Lord Palmerston in exasperation, "do these Islands belong to us or to Victor Hugo and Co?"

This year, Guernsey belongs once again to Victor Hugo. There will be lectures, exhibitions, themed walks, film and music festivals, a pantomime "Hunchback of Notre Dame", and special "Les Misérables" stamps issued by the Guernsey post office. Hauteville House—a dignified Georgian townhouse which Hugo turned into a DIY Gothic cathedral—is to be reopened. It was there that Hugo wrote the greatest works of English literature in French: "Les Misérables" and three magnificent novels that used to be international bestsellers: "Toilers of the Sea", "The Laughing Man" and "Ninety-Three".

In Paris (which some thought should be re-named Hugopolis), the face that appears on posters and newsstands is the white-bearded sage of the Third Republic—the secular god who used to stare down from classroom walls at pupils who were forced to memorise his poems. But even the old sage in a suit refused to be a passive mascot. The same Victor Hugo went gadding about Paris on the top deck of the omnibus, scribbling poems and picking up pretty women, to the embarrassment of his son-in-law, who sat in the French parliament.

If Hugo had been the logo of a single regime, no one would now be celebrating his 200th birthday. It was his spectacular betrayals and courageous posturings, his willingness to be the scapegoat and the buffoon, that made him the national poet. Hugo's oratory suits grand occasions, but he was also the voice of his nation's bad conscience, and that nation still lives with the ghosts of its past: the Dreyfus affair, the Vichy government, the Algerian war and the rise of the National Front. "There are some crayfish souls", said Hugo, thinking of Napoleon III, "forever scuttling backwards into the darkness."

Birthdays are not conducive to free speech. But a republic that invites its citizens to open the Pandora's box of Hugo's vast oeuvre is a visible improvement on the last Napoleon.

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About sponsorship

New fiction

Coming home

Feb 14th 2002
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Im Krebsgang
By Günter Grass

Steidl Verlag; 216 pages; euro 18

Buy it at
Amazon.de

THE last time Günter Grass published a novel it was a critical disaster in Germany. “Ein weites Feld” (Too Far Afield) dealt with the big German issue of the moment, the unification of east and west, which, Mr Grass suggested, was really a brutal takeover. Sour grapes from a disgruntled old lefty, cried Germany's literati, whose scorn was summed up by a magazine cover photo of the country's most prominent critic tearing the novel in half. Now, almost seven years later, with the publication of “Im Krebsgang”, all seems to have been forgiven. Marcel Reich-Ranicki, the tome-ripping critic, has welcomed Mr Grass's latest work of fiction as a masterpiece which moved him to tears.

Such praise is deserved. In just over 200 pages Mr Grass tells a haunting tale of the sinking of a German refugee ship, the *Wilhelm Gustloff*, by a Soviet submarine in the Baltic Sea in the closing months of the second world war. Some 9,000 passengers, many of them women and children, died.

Paul Pokriefke, the narrator, is a *Gustloff* survivor, born on the night of the sinking. Whereas his mother, Tulla, later sees her whole life in reference to that one calamitous moment, Paul wishes their existence could have been more normal. For his teenage son, Konrad, a dabbler in the dark, far-right corners of the Internet, the *Gustloff* embodies the denial of German wartime suffering. So the novel, whose title literally means “crablike” or, as the narrator points out, the process of scurrying backwards to go forwards, is also about those very German subjects of historical memory and generational conflict.

Lacking the baroque flourishes of other of Mr Grass's works, the story is neatly told. It helps that Mr Grass has returned to his home turf (he was born 75 years ago in the German-speaking, free city of Danzig, now the Polish Gdansk). The Baltic coast and the dialect of its inhabitants, which provided the settings and sounds of his earlier triumphs, notably “The Tin Drum”, are masterfully conjured up. And Mr Grass is no stranger to modern phenomena such as Internet chatrooms. By placing Tulla in eastern Germany and sending Paul westwards to a small town with an ugly recent history of racist attacks, he highlights unresolved east-west differences and abiding xenophobia. Thus, while the book is focused on past events, it has a highly contemporary feel.

Mr Grass's concerns are underscored by his own appearance in the novel. The old man, as he calls himself, watches over Paul's shoulder and is full of self-reproach for ignoring Germany's wartime suffering. It seemed insignificant—perhaps even deserved—set against the crimes Germans committed in their country's name. Acknowledging those crimes was a matter of urgency for Mr Grass and his political friends in the 1960s, just as the excesses of Germany's foes, above all Russia, became the counter-cry of the right-wing generation that followed, with each side accusing the other of moral one-sidedness.

A strong temptation will be to treat “Im Krebsgang” as a recantation, a concession to the view that, regardless of how far the sins of Bolshevism can absolve those of the Nazis, Germany is now a normal country again. There is a whiff of that from critics who derided Mr Grass in 1995 and fete him now. But such readings miss the subtlety of Mr Grass's fictional responses. Germany is indeed normal, but it does not have a normal past. In recognising the sufferings of Germans, Mr Grass is filling in and balancing out his vision of Germany, not painting it in pink or pretending it is Switzerland.

Nor is he complacent about the German present. “Im Krebsgang” closes as neo-Nazi support-groups form on the net for Konrad, who is in jail for killing a man he takes for Jewish. Its last words are “Das hört nicht auf. Nie hört das auf.” (It doesn't stop. It never stops.) The argument will indeed go on. Critics have been telling Mr Grass for years that political fiction is dead. It is a triumph for him to have continued the great national debate in a novel.

Im Krebsgang.
By Günter Grass.
Steidl Verlag; 216 pages; euro 18

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About sponsorship

George Soros

Philosopher manqué

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IN 1944, when George Soros was 13, his well-to-do Jewish family sent him away from Budapest to live in the countryside under an assumed name. He had to pretend to be called Sandor Kiss and to address his mother as Auntie Julia. The family was reunited when Russian soldiers took the city the next year, though not before his mother had been raped by their liberators. To survive, the family lived on the streets in conditions far worse than Harry Lime's Vienna.

Soros: The Life and Times of a Messianic Billionaire
By Michael T. Kaufman

Knopf; 368 pages; $27.50

Buy it at
Amazon.com
Amazon.co.uk

Many years later, though, Mr Soros remembered this as the most exciting time of his life. None of the risks he would take as the most successful financial speculator of the last quarter of the 20th century came close to recreating that excitement. Mr Soros is not unique in being driven by the desire to match the thrills of a war-torn youth, just extraordinary in the lengths to which he has gone to do so.

At one time he was earning more than anyone else in America, and giving away more too—hundreds of millions of dollars a year in both cases. His brand of philanthropy was typified by the hundreds of Xerox copiers that he sent to communist Hungary in the 1980s, to encourage the free flow of information. Yet with Mr Soros as with most very rich men, the money is never enough. He remains frustrated, unable to realise his deepest desire: to write a philosophical treatise that “will be read for as long as our civilisation lasts”.

Michael Kaufman is a journalist who has worked for the *New York Times* and edited *Transitions*, a publication financed by Mr Soros. He is strong on the background to Mr Soros's East European philanthropy, but weaker on the hows and whens of his fortune-making. The book shifts halfway through into a lower gear and becomes a fragmented and partial dissection of a career. It skirts round the difficulties of the adult George's family life—his ambivalence towards Judaism and the suspicion that his first wife was dropped because she was too unassuming for a man who had decided he “wanted to be included in the councils”. Mr Soros's books and some of his speeches have been widely ridiculed, but Mr Kaufman avoids looking at them too closely. This is not, then, the last word on George Soros. But for those who know little about this remarkable (though hardly messianic) billionaire, it is a titillating first chapter.

Soros: The Life and Times of a Messianic Billionaire.
By Michael T. Kaufman.
Knopf; 368 pages; $27.50

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About sponsorship

Feminism

All the rage

Feb 14th 2002
From The Economist print edition

AT FIRST glance, the image of Andrea Dworkin in her trademark overalls couldn't contrast more starkly with that of Emmeline Pankhurst in her Edwardian tea-gowns and huge floppy hats. Credited with having won British women the vote, Pankhurst's agenda now seems perfectly mainstream, while Ms Dworkin has, perhaps unfairly, been consigned to the lunatic fringe of the women's movement. Yet in some ways Ms Dworkin's idealism and extremism put her closer to the Pankhursts than to today's pragmatic post-feminists.

Heartbreak: The Political Memoir of a Feminist Militant
By Andrea Dworkin

Basic Books: 224 pages; $24

Buy it at
Amazon.com
Amazon.co.uk

The Pankhursts
By Martin Pugh

Allen Lane, The Penguin Press; 560 pages; £20

Buy it at
Amazon.co.uk

Ms Dworkin, who has written a lyrical memoir, is a problematic figure for liberals because she sees the evil of pornography as greater than the good of free speech. To get rid of the one, she believes, it is worth compromising the other. Her concentration on the issue of porn (which she regards as an attack on women's civil rights), as well as on prostitution and on battered women (she bravely spoke out after being abused by her own husband), have caused many to assume, despite her denials, that she regards sexual violence as the paradigm for all gender relations.

Her focus on women as the victims of male sexuality puts her in a direct line of descent from the feminism of the late 19th century, which arose out of the campaigns against the Contagious Diseases Act. Ms Dworkin would understand why, at the height of the British government's crackdown on suffragette militancy in 1913, Christabel Pankhurst launched an offensive on male sexual depravity, attacking establishment figures for using prostitutes, and writing “The Great Scourge” to warn women to avoid marriage while men remained carriers of venereal disease.

Like Ms Dworkin, who began as a leftist and was briefly jailed for her part in a demonstration against the Vietnam war, the Pankhursts had their roots in the socialist radicalism of their day. Martin Pugh's monumental biography untangles the different personalities of the four Pankhurst women, and reveals an impressive but dysfunctional family. Emmeline, the mother, whom history would come to regard as the figurehead, was passionately idealistic but inept in the practicalities of domestic life. Her children grew up to believe that the only way to win love was to become involved in fighting for the cause.

Mr Pugh fascinatingly puts that cause in its historical context. The Pankhursts had a genius for publicity as well as an uncompromising willingness to use violent tactics and to risk death through hunger strikes. But they only represented one strand of a much broader suffrage movement. They increasingly excluded working-class women, and all men, from their essentially well-to-do, female support base. Their success in becoming so uniquely identified with the fight for the vote derives from their courage, energy and defiance, together with the chillingly single-minded commitment they brought to “the movement” and their ruthlessly autocratic, military ethos.

Christabel, the eldest, was a brilliant speaker, who, with her mother, took a violent swerve to the right at the time of the first world war, and—bizarrely—became an Adventist preacher after the suffragette movement was wound up. The more sympathetic Sylvia, an artist and the lover of Keir Hardie, remained loyal to her socialist principles, and went on to flirt with Leninism before becoming a champion of Ethiopian nationalism. Adela, the forgotten third sister, was bundled off to Australia after a family row, and pursued a political career there which lurched from left to right.

Now that it is nearly a century since the suffragettes' campaign began, it is possible for a painstaking researcher such as Mr Pugh to look at the Pankhursts with greater detachment than has previously been the case: they can be seen as humans rather than heroines. It will be interesting to see what future

historians of the women's movement make of Ms Dworkin.

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About sponsorship

Science and pregnancy

The flowering

Feb 14th 2002
From The Economist print edition

PREGNANCY guides generally come in two sizes: thin and fat. The thin offer little beyond drawings of the fetus's weekly progress from apostrophe to fully grown baby, while authors of the fat kind—Naomi Wolf is one—won't let you go until you have heard every emotional detail of their condition. Put it down to hormones, but when did you last see an intelligent and detailed scientific elucidation of the whole business? “Having Faith” is just such a book.

Having Faith: An Ecologist's Journey to Motherhood
By Sandra Steingraber

Perseus Publishing; 342 pages; $26 and £11.99

Buy it at
Amazon.com
Amazon.co.uk

Sandra Steingraber's doctoral thesis, on the effects of herbicides in northern Minnesota, documented how the area was routinely sprayed through the 1950s and 1960s with the same mix of chemicals that made up Agent Orange in Vietnam. Birth defects are more common in Minnesota's farming areas, especially in children conceived in spring, when pesticide use is at its highest. Ms Steingraber's interest when she fell pregnant, at 38, was how to marry her scientific knowledge with her growing wonder at the changes within her.

Ms Steingraber is also a poet, and her imagery of fetal growth—how some cells divide while others actually break free, sprout snail-like feet, and “walk over the bodies of their neighbours” before setting up house elsewhere—would be hard to beat. Even so, the simple developmental narrative is but a prelude to her main topic, which is how babies are affected by a toxic environment.

Details of well-known cases, such as Minamata's methylmercury tragedy in Japan—a byword for poisoned children—are to be expected in such a book. Far scarier in many ways is the normal,everyday toxicity of industrialised life. Pregnant women are routinely advised that bottled water is safer than what comes out of the tap. Yet our principal exposure to pollutants in tap water is through breathing, not drinking. A ten-minute shower will expose you to the same level of contaminants as drinking half a gallon of tap water, even if nothing but fancy French stuff ever passes your lips. Intelligent, thoughtful and beautifully written, Ms Steingraber's book, like Rachel Carson's before her, deserves to be called a classic.

Having Faith: An Ecologist's Journey to Motherhood.
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About sponsorship

European political history

Representative monarchy

Feb 14th 2002
From The Economist print edition

IN 1689 the French monarchy was the most powerful in Europe. Its dominance was as much cultural as military. In architecture and in the use of the French language, German courts paid it the compliment of imitation. One hundred years later, Louis XVI was forced to leave Versailles for the capital by an angry Paris mob. Yet other absolutist royal families, notably the Habsburgs, would survive until the wreck of old Europe in 1918. The present book offers to explain the cultural reasons why.

The Culture of Power and the Power of Culture: Old Regime Europe 1660-1789
By T.C.W. Blanning

Oxford University Press; 479 pages; $35 and £25

Buy it at
Amazon.com
Amazon.co.uk

T.C.W. Blanning, a professor of history at Cambridge University, makes use of Juergen Habermas's terms “representational culture” and “the public sphere”—though this is certainly not a work of uncritical discipleship. By representational culture is meant one in which the sovereign, who embodies the nation, exercises and displays—“re-presents”—his power before his subjects. Of such cultures, Louis XIV's France is the last great example.Although he did not say “L'état, c'est moi”, as Mr Blanning remarks, he might have done. Louis did not regard his kingdom as his property, and saw himself as a steward ruling under God and according to natural and customary law; but he believed that his *gloire* and that of the state were identical. As “patron of all the arts” (Dryden's admiring phrase), Louis subsumed the achievement of such varied geniuses as Molière and Racine to his own prestige. To an extent never seen in England, the court was the centre of taste as well as power.

Representational culture of this kind persisted into the 18th century, but a public sphere developed alongside it. With an expanding and increasingly literate population throughout Europe, the arts became commercialised, the author and the composer selling their productions through the publisher and the impresario. New forums for communication and debate—the newspaper, the circulating library, even the coffee-house—sprang up. Mr Blanning insists that the emerging public sphere was still partly aristocratic; but most importantly a public was now articulating its own cultural and political choices.

It was in its inability to adapt to changed conditions and to recognise the phenomenon of public opinion, Mr Blanning argues, that the French monarchy failed. Versailles and its increasingly ossified court rituals no longer testified to the greatness of the king but rather to his isolation from the nation. Royal building programmes and pageantry came to seem wasteful extravagance. The licentiousness of Louis XV, followed by the widely rumoured, though almost certainly fictitious, bisexual promiscuity of Marie Antoinette, brought the throne into disrepute.

Worse, the queen represented the shift to a pro-Austrian foreign policy which was widely perceived as having brought France only military and diplomatic humiliation. Thus the legitimacy of the Bourbon monarchy seeped away. Elsewhere, more decisive absolute monarchs, Frederick II and Joseph II, responded to the emergent cultural nationalism of their subjects by redefining their role as servants of the state. Within England's mixed constitution, George III—like Joseph frugal, hardworking and relatively informal—weathered the political crises of the first half of his reign to become the initiator of popular domestic monarchy.

Mr Blanning's emphasis falls on Louis XVI's failures and missed opportunities. One might object that he does insufficient justice to the reforming efforts of the king's ministers, and that there is still a case for de Tocqueville's thesis that *ancien régime* France destabilised because it too, like Austria, was trying to reform itself. Yet the fact that, unlike Austria, it failed to do so confirms what emerges strongly from this wide-ranging and accessible book: the extent to which successful absolutism depended upon the intelligence, energy and charisma of the monarch himself.

The Culture of Power and the Power of Culture: Old Regime Europe 1660-1789.
By T.C.W. Blanning.
Oxford University Press; 479 pages; $35 and £25

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Mountaineering

Cliffhanger

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From The Economist print edition

JOE SIMPSON is renowned for “Touching the Void”, the astonishing tale of his six-mile solo descent, with broken legs, from a mountain in Peru. Published in 1988, the story has become an adventure classic for all time, while the fine writing established Mr Simpson's literary credentials. He has since shown an enviable knack for both surviving and brilliantly describing his countless epic scrapes in the mountains.

The Beckoning Silence
By Joe Simpson

Jonathan Cape; 308 pages; £17.99

Buy it at
Amazon.co.uk

In “The Beckoning Silence” he reflects on turning 40, on the arthritic creak of battered bones and on the loss of climbing colleagues in accidents—noting dryly that “if you keep putting your head in a lion's mouth, one day he's going to shut it”. As he tells of his escapades in Peru, Colorado and the Alps, he admits that the mountaineering bug has, for him, begun to pall. Yet he can't quite resist the endorphin surges from fear (or its conquest) and the more aesthetic allure of rocks, snow and ice. Plus he still has some “unfinished business”: the Eiger. “Just the word got my heart pounding.”

In recent years Everest has become the site of grotesque existentialist consumerism, with clients with little or no climbing experience paying $64,000 to be cocooned by Sherpas and eased up the slopes. The north face of the Eiger, by contrast, is still reckoned a serious mountaineer's graduation piece—13,025 feet of climbing, almost two miles uphill, over some of the most inhospitable terrain on the planet. More than 60 people have died in the attempt since the 1930s. Even in Switzerland, where mobile phones can summon rescue helicopters in minutes, where tourists crowd hotel terraces and peer through telescopes at the life-and-death struggles enacted on the great wall above them, no guides venture up the Eiger with unseasoned clients. It remains the pre-eminent Alpine route.

Mr Simpson is a born storyteller. The account of his final retreat off the face after a flash storm in which three climbers died (caught on film by a British documentary crew from the hotel below) will have any reader, even the most experienced climber, on the edge of his seat.

There is a universal appeal in the quality of Mr Simpson's writing, his self-deprecating candour and his compulsive urge to “play games with eternity”. He mentions that he plans to start writing novels, but it is unclear how he could surpass in fiction what he here relates as fact.

The Beckoning Silence.
By Joe Simpson.
Jonathan Cape; 308 pages; £17.99

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About sponsorship

Classical pianists

Getting to the music's heart

Feb 14th 2002
From The Economist print edition

How a small, cold country produced a pianist of warmth, intelligence—and worldwide reputation

Framing silence

EDVARD GRIEG, Norway's most celebrated composer, once remarked that he wasn't able to build castles and palaces like Beethoven but he could create small houses of great intimacy. Leif Ove Andsnes, a young Norwegian musician who is fast gaining a reputation as one of the top pianists of the day, understands the difference well. Among his many musical gifts is an attention to the individuality of the composers he plays.

When starting out, he performed Grieg, and more Grieg, but wanted to avoid being typecast as a Nordic wonder. Soon he was winning critics and audiences with distinctive interpretations of Brahms, Haydn, Janacek, Liszt and Schumann. His breadth of repertoire assured, he recently returned to his native land to record Grieg's intimate Lyric Pieces, on the composer's own 1892 Steinway at his museum-home in Troldhaugen. Attentive also to the temper of individual pianos, Mr Andsnes describes its sound as “transparent, not thick, the treble very bell-like—a lovely quality”.

He could perfectly well be talking about the warmth and clarity that mark his own playing. Among young pianists, peerless technique and beautiful sound are taken for granted. What most impresses listeners about Mr Andsnes is his poetic intensity and his utter absorption in the tasks of musical expression. Jiri Hlinka, his teacher, insisted that while playing he use his whole body. He wasn't asking him to be flamboyant, just totally engaged.

The piano fascinated Mr Andsnes early. He was born in Karmoy 32 years ago. His father, a music teacher, organised the school band and taught piano. When he was three, Mr Andsnes remembers lying under the family piano while another child took a lesson, drinking in the sound. Although he quickly proved an adept, and was playing Mozart sonatas by the time he was six, Mr Andsnes had no thought of turning professional until he went to study under Mr Hlinka, a Czech musician resident in Bergen. It was Mr Hlinka, Mr Andsnes explains, who opened up all sorts of possibilities and pointed him to how the classics could speak to people's hearts. “He is a very Slavonic, emotional musician.” It was then he realised there was no going back.

Unlike some solo piano stars, Mr Andsnes enjoys being and working with other musicians, particularly in chamber groups. At the age of nine, he wryly recalls, winning first-prize in a young-musicians' contest obliged him to sit out the competition for two years, and he missed the company of the other young contestants. Every spring now he runs a music festival in the town of Risor, south-west of Oslo. It began in 1991, and he became co-ordinator two years later. The concerts take place in a wooden baroque church, which seats 500 people but feels smaller. The performers spend a week in rehearsal together beforehand, and many have become friends.

The enthusiasm he voices for the talents and work of fellow performers is genuine. He is a sterling accompanist. This month Mr Andsnes joins Matthias Goerne, an outstanding German baritone, for programmes of Brahms Lieder in St Petersburg, London and Munich. He enjoys the variety. “It's a different skill,” he says, “something very pleasant, because no matter how much you rehearse, each concert, each song is different, depending on the evening, the hall, the audience.”

Despite an understandable weariness with Grieg's warhorse, the Piano Concerto in A minor, which every orchestra asked him to play earlier on, Mr Andsnes is justly proud of Norway's musical tradition. He

champions its less familiar composers, such as Johansen, Saeverud and Tveitt, treating this as an adventure. “Norway is a young country,” he says, “maybe everyone there is still engaged on a search for our national identity and integrity. It's the same with Norwegian music: there's a lot to discover, a lot we don't know yet.”

A down-to-earth simplicity balances his romantic streak. He loves Norway's countryside, and returns there whenever he can. “I was lucky to grow up in a country where we can enjoy silence,” he muses. “To get to the mountains, to hear a brook running, a bird singing, that's really music for me.” You realise that this is more than a banality when, in explanation, he describes rehearsals with colleagues for a chamber concert as “putting a frame around the silence”.

The strongest personal impression a listener is likely to take away from a conversation with Mr Andsnes is a touching modesty in character and manner. He was honestly surprised when, at the age of 17, the Bergen Festival invited him to play, and something of this unaffected capacity for wonder has remained with him ever since. This year's Risor festival will focus on the music of two Viennese masters, Schubert and Schoenberg. “Schubert is for me the treasure,” he says. “I waited for a while before trying to play his music.”

Listeners to Mr Andsnes's playing will be impressed—and moved—by many things. He has the confident simplicity of true talent: an understanding of how difficult things are and an ability to focus without ego on the music's essentials. When hearing him play, you wonder if he sees or pictures the music, so clear and tangible does he make its structures seem, be they a castle of Beethoven's or a small house of Grieg's. Never is there a hint of rigour or coldness. Each musician, Mr Andsnes says, must find what is closest to their heart and concentrate on that.

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Princess Margaret

Feb 14th 2002
From The Economist print edition

Princess Margaret Rose died on February 9th, aged 71

IF THE life of the British royal family is the world's most brilliant soap opera, as some regard it, Princess Margaret was its most enduring and creative performer. In her prime she never failed to provide some new and intriguing twist in the script to beguile the less privileged millions as they faced another wearisome day. The competition was sometimes fierce. In the republics of Europe there are many who cling to their obsolete titles, countess this, marquise that. “First ladies” tend to adopt royal airs but their reigns abruptly end when their political husbands lose their jobs. For editors of newspapers and television, fierce guardians of the gates to fame, Princess Margaret was the real thing, an authentic living royal; moreover, and this was the important thing, she had a happily uninhibited streak. Our picture is of the princess at a London nightclub.

Margaret's Uncle Edward was really the founder of Britain's royal soap opera. He was the king who gave up his throne in 1936 so that he could marry Wallis Simpson, a twice-divorced American. Newspapers were more discreet then and television was in its infancy. But after the improbable story was made public, it ran and ran, became even more improbable when the couple were courted by Hitler, and never really faded until their deaths, of Edward in 1972 and Wallis in 1986.

The new king, George, seemed a dull stick. He was a disappointment after the lively Edward. However, George had two engaging daughters, Margaret, aged six, and her elder sister Elizabeth, ten. They were the first and second in line to the throne, and rapidly became the most famous children in the western world. Still, there is only a limited amount to say about children, however captivating, so, as is possible with soap operas, it is best to fast forward to a more interesting episode.

Behind palace walls

An American film called “Roman Holiday”, first shown in 1953, starred Audrey Hepburn as a princess who runs away to Rome in rebellion against her stuffy life at home. It won numerous Oscars and started Belgian-born Miss Hepburn on a successful Hollywood career. The clever script was written under a false name by Dalton Trumbo who had fallen foul of Joe McCarthy while he was hunting communists. But what mostly interested many filmgoers was that Miss Hepburn resembled Princess Margaret and it was assumed that Margaret was a rebel too.

The mixture of unverifiable fact wrapped in fiction that came to be written about Margaret seems to date from this time. What was known about life behind palace walls 50 years ago sounded pretty gloomy. When Elizabeth became queen on the death of her father in 1952, her grandmother, a previous queen, had curtsied to her. Did Margaret curtsy to her sister? Presumably. It seemed a rum way to run a family.

When Elizabeth was crowned the following year an alert photographer snapped Margaret removing what seemed to be a piece of fluff from the uniform of one Peter Townsend. Princesses are not expected to be valets. What was the meaning behind this extraordinarily unroyal act? There was much deliberation among the knowing. A long episode of the soap opera began to unfold. Townsend had been a fighter pilot in the second world war, the first in the RAF to shoot down a German bomber, and had later become an aide to the king, Margaret's father. Margaret, it was said, had become fond of him. But he was 16 years older than the princess and, worse, had been divorced.

Margaretologists noted that Townsend looked a bit like Gregory Peck, who had starred with Audrey Hepburn. But in 1955 Margaret put an end to the guessing and said that she was not marrying him. She married Antony Armstrong-Jones, a photographer, in 1960. The 1960s seemed the decade she was born for. She was as much of the period as the Beatles, the mini-skirt and the joy of sex. *Time* magazine accorded London the adjective “swinging”. Margaret and Tony (by now a lord) made it their playground.

The marriage broke up in 1978. The frolics of the period had long begun to pall. Gossips said Margaret had a number of affairs. Jean Cocteau said she told him that she loved disobedience: “I've always been the naughty one.” Margaret became the princess who did not live happily ever after, which may or may not have been true. Royal despair may be different from the ordinary sort. For Margaret it was sitting next to a bore at a state dinner. However, thoughts she might have had about becoming queen had been put aside: she had fallen to 11th in line to the throne.

The guardians of true fame began to look elsewhere for interesting candidates. Margaret's two children have turned out to be unhelpfully normal. However, in the late 1970s the guardians' patience was rewarded by the emergence of Princess Diana whose every public moment they diligently recorded until her death in 1997. In Diana's time the palace walls had become more transparent, but it was Margaret who had first let in a little light. Those who were not alive when Margaret was in the spotlight may have been surprised by the vast amount of newspaper space and airtime that followed her death. But it was the media's way of saying thank you.

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Overview

Feb 14th 2002
From The Economist print edition

An **American** shopping spree sparked increased hopes of a quick end to the recession. Total retail sales fell by 0.2% in value terms in January, but this reflected the end of last autumn's zero-interest-rate car-financing deals. Excluding cars, retail sales climbed by 1.2%, the biggest rise in nearly two years.

Less optimistically, the National Bureau of Economic Research, America's official recession arbiter, announced that it does not plan to declare an end to the recession in the near future. It referred to continuing economic weakness in manufacturing output and jobs.

In contrast to America's spendthrift consumers, shoppers in **Japan** have been staying at home: retail sales fell by 4.4% in volume in the year to December.

German retail sales fell by 4.1% in volume in the year to December. Industrial production also fell by 3.5% in the 12 months to December, the sixth straight month of year-on-year decline.

Britain's underlying rate of consumer-price inflation, excluding mortgage payments, jumped above the Bank of England's 2.5% target rate, to 2.6% in January. This was due largely to rises in the prices of petrol, food and telecommunications. Producer-price deflation eased, from 1.0% in the year to December to 0.5% in the year to January. Unemployment rose to 5.2% in December.

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Output, demand and jobs

Feb 14th 2002
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	1 qtr	1 year	2001	2002	latest		latest		latest		year ago
Australia	+ 4.6	+ 2.5 Q3	+ 2.2	+ 3.3	+ 0.4	Q3	+ 4.8	Q4	7.0	Jan	6.3
Austria	– 0.3	+ 0.9 Q3	+ 1.0	+ 1.0	– 5.5	Nov	nil	Oct	4.2	Dec	3.6
Belgium	+ 0.1	+ 0.6 Q3	+ 1.1	+ 1.0	– 9.3	Nov*	– 2.5	Oct	10.9	Jan*	10.7
Britain	+ 1.0	+ 1.9 Q4	+ 2.4	+ 1.9	– 4.6	Dec	+ 5.7	Dec	5.2	Dec†	5.3
Canada	– 0.8	+ 0.8 Q3	+ 1.4	+ 1.4	– 6.0	Nov	+ 2.1	Oct	7.9	Jan	6.9
Denmark	+ 3.5	+ 1.4 Q3	+ 1.1	+ 1.3	– 6.3	Dec	+ 1.5	Dec	5.0	Dec	5.4
France	+ 1.8	+ 1.9 Q3	+ 2.1	+ 1.4	– 0.9	Nov	– 0.8	Nov	9.0	Dec	9.0
Germany	– 0.6	+ 0.3 Q3	+ 0.7	+ 0.7	– 3.5	Dec	– 4.1	Dec	9.6	Jan**	9.3
Italy	+ 0.6	+ 1.9 Q3	+ 1.8	+ 1.1	– 5.8	Nov	– 0.9	Nov	9.3	Oct	10.0
Japan	– 2.1	– 0.5 Q3	– 0.4	– 1.3	–15.3	Dec	– 4.4	Dec	5.6	Dec	4.9
Netherlands	nil	+ 0.4 Q4	+ 0.9	+ 1.1	– 6.2	Dec	+ 0.5	Nov	1.9	Dec§	2.6
Spain	+ 1.1	+ 2.8 Q3	+ 2.6	+ 1.8	– 4.5	Dec	na		12.9	Dec	13.5
Sweden	+ 0.2	+ 0.4 Q3	+ 1.2	+ 1.4	– 5.1	Nov	+ 1.0	Dec	3.6	Dec*	3.7
Switzerland	+ 0.1	+ 0.8 Q3	+ 1.4	+ 0.9	+ 1.9	Q3*	+ 1.2	Dec	2.6	Jan*	2.0
United States	+ 0.2	+ 0.1 Q4	+ 1.1	+ 1.2	– 5.8	Dec	+ 6.5	Dec	5.6	Jan	4.2
Euro area	+ 0.4	+ 1.4 Q3	+ 1.5	+ 1.1	– 4.3	Nov	+ 1.3	Nov	8.5	Dec	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 5.0	nil Q3	na	na	– 3.1	Dec	+ 5.0	Oct	8.1	Dec*	8.3
Greece	na	+ 4.4 Q3	na	na	+ 0.7	Nov*	+ 4.1	Oct	na		na
Iceland	na	+ 3.62000	na	na	+ 2.5	2000	na		1.8	Dec	1.3
Ireland	na	+ 9.2 Q2	na	na	+ 1.6	Dec	+ 3.5	Nov	4.1	Jan	3.6
Luxembourg	na	+ 8.52000	na	na	+ 6.1	Nov	+10.0	Oct	2.7	Nov	2.6
New Zealand	+ 2.8	+ 2.1 Q3	na	na	+ 2.6	Q3*	+ 7.4	Q4	5.4	Q4	5.6
Norway	+ 3.8	+ 1.9 Q3	na	na	+ 1.2	Dec	+ 2.2	Dec	3.3	Q4	3.1
Portugal	– 1.0	+ 1.3 Q3	na	na	– 2.2	Dec	nil	Dec	4.0	Q3	4.0

*Not seasonally adjusted. †Oct-Dec; claimant count rate 3.2% in Jan. §Oct-Dec. **EU harmonised rate 8.1% in Jan.

Text refers only to the first 16 countries listed

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Prices and wages

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From The Economist print edition

% change at annual rate

	Consumer prices* latest		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	The Economist poll consumer prices forecast 2002	Producer prices* latest		Producer prices* year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 3.1	Q4	+ 5.8	+ 4.1	+ 2.4	– 0.7	Q4	+ 8.4	+ 4.0	Q3	+ 6.5
Austria	+ 1.9	Dec	+ 2.6	+ 2.6	+ 1.5	– 0.4	Jan	+ 3.2	+ 2.7	Dec	+ 2.2
Belgium	+ 2.9	Jan	+ 2.2	+ 2.5	+ 1.5	– 2.6	Dec	+ 7.3	+ 3.1	Q4	+ 1.6
Britain	+ 1.3	Jan	+ 2.7	+ 1.9	+ 1.9	– 0.5	Jan	+ 1.7	+ 3.3	Dec	+ 4.4
Canada	+ 0.7	Dec	+ 3.2	+ 2.6	+ 1.2	– 2.3	Dec	+ 2.4	+ 2.5	Nov	+ 2.6
Denmark	+ 2.5	Jan	+ 2.3	+ 2.3	+ 1.8	+ 0.4	Dec	+ 3.9	+ 4.3	Q3	+ 3.8
France	+ 1.4	Dec	+ 1.6	+ 1.7	+ 1.1	– 1.6	Dec	+ 4.7	+ 4.1	Q3	+ 5.3
Germany	+ 2.1	Jan	+ 2.4	+ 2.4	+ 1.2	– 1.5	Dec	+ 5.1	+ 1.9	Nov	+ 1.8
Italy	+ 2.4	Jan	+ 3.0	+ 2.5	+ 1.8	– 1.3	Dec	+ 6.2	+ 2.8	Dec*	+ 1.7
Japan	– 1.2	Dec	– 0.4	– 0.7	– 0.9	– 0.6	Jan	+ 1.1	– 0.5	Dec*	+ 1.0
Netherlands	+ 4.0	Jan	+ 4.2	+ 4.8	+ 2.4	– 2.2	Dec	+ 7.6	+ 4.6	Nov	+ 3.3
Spain	+ 2.7	Dec	+ 4.0	+ 3.6	+ 2.3	– 0.8	Dec	+ 5.0	+ 3.6	Q3†	na
Sweden	+ 2.9	Dec	+ 1.4	+ 2.6	+ 2.0	– 0.8	Dec	+ 3.7	+ 3.0	Nov*	+ 2.2
Switzerland	+ 0.5	Jan	+ 1.3	+ 1.0	+ 0.6	– 1.9	Dec	+ 2.2	+ 1.3	2000	+ 0.3
United States	+ 1.6	Dec	+ 3.4	+ 2.9	+ 1.4	– 1.8	Dec	+ 3.6	+ 4.0	Jan	+ 3.9
Euro area	+ 2.5	Jan	+ 2.4	+ 2.6	+ 1.5	– 1.1	Dec	+ 5.4	+ 2.9	Q3	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.6	Dec	+ 3.5	na	na	– 2.7	Dec	+ 5.9	+ 4.5	Q3*	+ 4.9
Greece	+ 3.0	Dec	+ 3.9	na	na	+ 2.4	Dec	+ 6.7	na		na
Iceland	+ 8.9	Feb	+ 4.1	na	na	+11.4	Jan	+ 4.4	+ 9.6	Dec	+ 7.6
Ireland	+ 4.2	Dec	+ 5.9	na	na	nil	Dec	+ 4.5	+ 8.7	Q3*	+ 7.4
Luxembourg	+ 1.7	Dec	+ 3.5	na	na	– 1.1	Nov	+ 5.0	+ 3.4	Aug*	+ 7.0
New Zealand	+ 1.7	Q4	+ 4.0	na	na	+ 6.2	Q3	+ 8.4	+ 2.2	Q4	+ 1.6
Norway	+ 1.3	Jan	+ 3.4	na	na	– 8.2	Jan	+ 3.3	+ 4.6	Q3*	+ 4.2
Portugal	+ 3.7	Dec	+ 3.9	na	na	– 9.4	Dec	+13.5	+ 2.4	Apr*	na

*Not seasonally adjusted. †New series.

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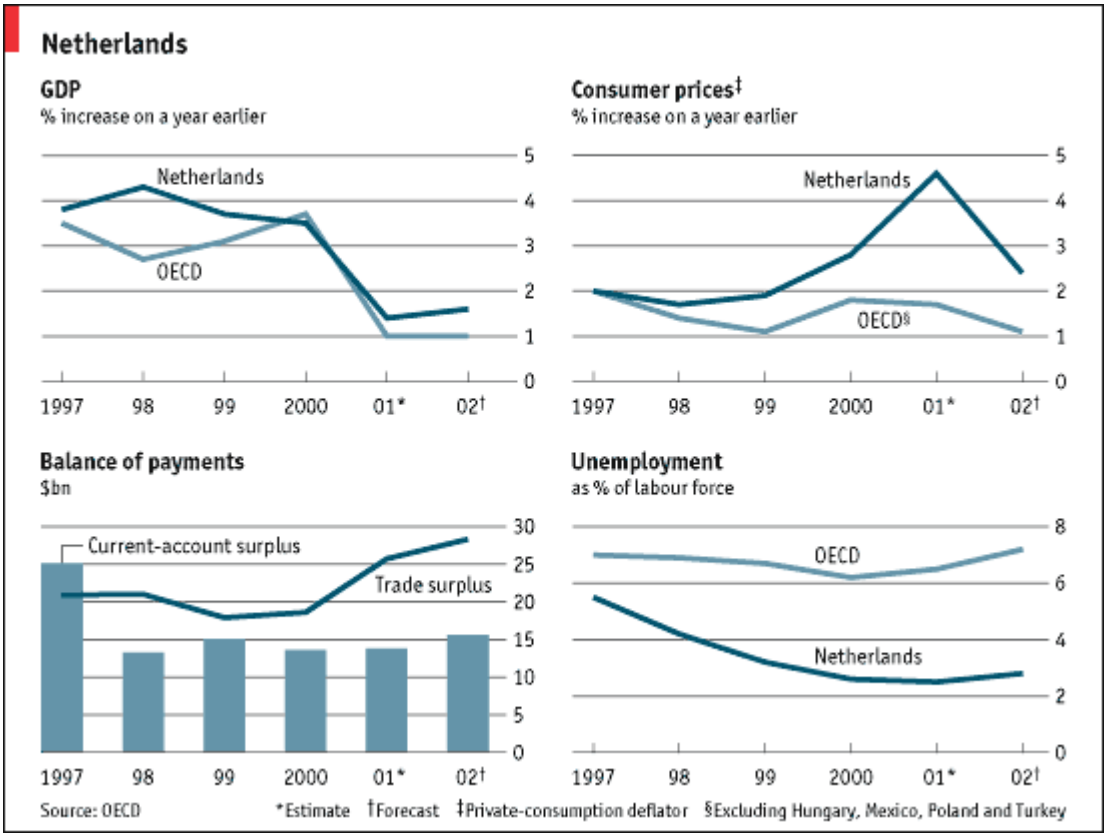
Netherlands

Feb 14th 2002
From The Economist print edition



Last year GDP growth in the Netherlands dropped to about 1½%, having averaged nearly 4% between 1997 and 2000. In its annual country report, the OECD says that the global downturn offset the expansionary effects of an income-tax reform that kicked in at the start of 2001. After two decades of sustained non-inflationary growth the Dutch economy faces testing times. Although the OECD praises the structural reforms undertaken so far, it says more are needed, including an effort to get “inactive” people—those neither in work nor seeking it—back into the labour force. This looks daunting, because a large proportion of such people are over 50 and have been out of work for some time. However, an increase in the employment rate and other measures to boost productivity growth would help the Netherlands to cope with the consequences of an ageing population.

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Money and interest rates

Feb 14th 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Feb 13th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+21.8	+14.9	Dec	4.30	5.65	4.78	6.01	5.32	6.98
Britain	+ 7.9	+ 6.7	Dec	3.94	5.69	4.75	5.02	4.80	6.09
Canada	+15.3	+ 4.9	Dec	2.04	5.16	3.32	5.45	5.49	6.85
Denmark	+ 6.6	+ 6.5	Dec	3.68	5.02	4.30	5.12	5.03	7.01
Japan	+16.0	+ 3.6	Jan	0.04	0.33	0.07	1.49	1.40	1.57
Sweden	+ 7.1	+ 6.2	Nov	3.83	4.00	4.79	5.33	4.77	5.53
Switzerland	+ 6.3	+ 4.7	Dec	1.67	3.48	2.48	3.49	3.38	4.67
United States	+ 8.3	+12.9	Dec	1.77	5.18	3.07	5.04	5.23	6.81
Euro area†	+ 5.0	+ 8.0	Dec	3.36	4.66	3.89	4.92	4.72	5.63

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.45%, Japan No.236 1.50%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 14th 2002
From The Economist print edition

1995=100

	Feb 5th	Feb 12th*	% change on one month	% change on one year
Dollar index				
All items	67.0	67.5	– 0.3	– 5.2
Food	67.6	67.7	– 2.6	– 3.2
Industrials				
All	66.1	67.2	+ 3.0	– 7.8
Nfa†	63.6	66.6	+ 7.9	+ 2.3
Metals	68.2	67.8	– 0.7	–14.7
Sterling index				
All items	74.5	74.5	+ 0.6	– 3.8
Euro index				
All items	101.4	101.3	+ 1.4	– 0.3
Yen index				
All items	95.4	95.5	+ 0.9	+ 7.3
Gold				
$ per oz	291.95	300.00	+ 5.3	+14.9
West Texas Intermediate				
$ per barrel	20.10	20.60	+ 2.9	–31.6

* Provisional. † Non-food agriculturals.

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Stockmarkets

Feb 14th 2002
From The Economist print edition

Market indices

	Feb 13th	2001-02 high	2001-02 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,415.0	3,425.2	2,867.4	+ 1.4	– 0.3	+ 8.3	– 0.9
Austria (ATX)	1,225.6	1,245.8	1,014.3	+ 3.0	–29.4	+14.2	+ 6.1
Belgium (Bel 20)	2,788.4	3,030.4	2,322.6	+ 1.8	–24.3	– 7.8	–14.4
Britain (FTSE 100)	5,153.9	6,334.5	4,433.7	+ 1.6	–25.6	–17.2	–20.6
Canada (Toronto Composite)	7,561.4	9,348.4	6,513.1	+ 0.9	–33.6	–15.4	–20.1
Denmark (KBX)	222.2	294.3	197.8	+ 1.5	–26.4	–16.1	–21.7
France (SBF 250)	2,854.6	3,820.2	2,335.3	+ 1.8	–35.0	–24.3	–29.7
(CAC 40)	4,364.5	5,998.5	3,652.9	+ 2.1	–37.0	–26.4	–31.6
Germany (Xetra DAX)	4,935.4	6,795.1	3,787.2	+ 2.7	–38.8	–23.3	–28.7
Italy (BCI)	1,373.4	1,948.4	1,082.9	– 0.4	–37.1	–28.3	–33.4
Japan (Nikkei 225)	9,968.4	14,529.4	9,420.9	+ 5.8	–74.4	–27.7	–37.9
(Topix)	983.2	1,441.0	863.4	+ 6.6	–65.9	–23.4	–34.3
Netherlands (AEX)	493.5	642.3	396.2	+ 2.5	–29.7	–22.6	–28.1
Spain (Madrid SE)	788.3	963.9	648.6	+ 1.7	–31.2	–10.5	–16.8
Sweden (Affarsvarlden Gen)	218.4	293.1	177.5	+ 1.4	–45.4	–21.4	–29.9
Switzerland (Swiss Market)	6,337.0	8,135.4	5,110.2	+ 3.8	–24.7	–22.1	–25.7
United States (DJIA)	9,989.7	11,337.9	8,235.8	+ 3.5	–14.8	– 7.4	– 7.4
(S&P 500)	1,118.5	1,373.7	965.8	+ 3.2	–26.8	–15.3	–15.3
(Nasdaq Comp)	1,859.2	2,859.2	1,423.2	+ 2.6	–63.2	–24.7	–24.7
Europe (FTSE Eurotop 300)*	1,221.2	1,545.5	998.9	+ 2.4	–28.4	–20.4	–26.0
Euro area (FTSE Ebloc 100)*	1,051.8	1,404.1	843.6	+ 2.4	–32.2	–24.4	–29.8
World (MSCI)†	968.0	1,249.2	856.6	+ 3.3	–33.2	na	–20.7
World bond market (Salomon)‡	434.4	461.7	420.6	– 0.1	– 5.5	na	– 2.2

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Schroder Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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Trade, exchange rates and budgets

Feb 14th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2001	2002	Exchange rate trade-weighted† Feb 13th	year ago	Currency units per $ Feb 13th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2001‡
Australia	+ 2.0	Dec	− 8.5	Q3	− 2.2	− 2.9	73.5	72.0	1.97	1.89	2.78	1.71	1.47	0.1
Austria	− 5.0	Oct	− 4.3	Nov	− 2.3	− 2.0	100.1	100.4	15.8	15.0	22.4	13.8	11.9	nil
Belgium	+ 12.2	Nov	+ 12.4	Sep	+ 4.0	+ 4.3	98.7	99.2	46.4	43.9	65.6	40.3	34.8	nil
Britain	− 41.1	Nov	− 17.7	Q3	− 1.5	− 2.1	107.8	104.9	0.71	0.68	–	0.61	0.53	1.1
Canada	+ 42.5	Nov	+ 23.9	Q3	+ 2.8	+ 1.9	76.1	78.2	1.60	1.53	2.27	1.39	1.20	2.8
Denmark	+ 6.8	Dec	+ 4.1	Dec	+ 2.8	+ 2.3	102.0	102.0	8.55	8.13	12.1	7.43	6.40	2.0
France	+ 2.7	Nov	+ 24.1	Nov	+ 1.6	+ 1.5	101.3	101.9	7.55	7.14	10.7	6.56	5.65	-1.5
Germany	+ 84.0	Dec	+ 9.9	Dec	− 0.4	− 0.1	98.3	98.9	2.25	2.13	3.18	1.96	1.68	-2.5
Italy	+ 6.9	Nov	+ 1.9	Nov	− 0.2	+ 0.2	72.3	72.7	2,228	2,108	3,151	1,936	1,668	-1.4
Japan	+ 70.4	Dec	+ 91.3	Dec	+ 2.1	+ 2.2	127.9	143.1	134	117	189	116	–	-6.4
Netherlands	+ 20.2	Nov	+ 11.8	Q4	+ 3.6	+ 3.7	97.6	98.1	1.15§	1.09	1.62	–	0.86	1.1
Spain	− 38.4	Oct	− 14.1	Oct	− 2.5	− 2.3	74.0	74.4	191	181	271	166	143	nil
Sweden	+ 12.5	Dec	+ 5.9	Dec	+ 2.6	+ 2.5	75.4	77.6	10.60	9.86	15.0	9.22	7.94	3.8
Switzerland	+ 1.0	Dec	+ 25.4	Q3	+10.0	+10.1	111.3	107.7	1.69	1.67	2.40	1.47	1.27	na
United States	−434.0	Nov	−430.7	Q3	− 4.0	− 4.1	123.7	115.4	–	–	1.41	0.87	0.75	0.6
Euro area	+ 32.6	Nov	− 24.5	Nov	− 0.2	nil	78.1	79.4	1.15	1.09	1.62	–	0.86	-1.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 11.1	Nov	+ 8.3	Dec	na	na	78.0	78.2	6.82	6.47	9.64	5.92	5.10	3.7
Greece	− 19.3	Oct**	− 8.2	Oct	na	na	57.4	57.5	391	371	553	340	293	0.2
Iceland	− 0.2	Nov	− 0.7	Q3	na	na	na	na	101	86.1	143	87.7	75.6	-0.2
Ireland	+ 31.6	Nov	− 1.5	Q2	na	na	86.7	87.9	1.15§	1.09	1.62	1.00	0.86	3.2
Luxembourg	− 2.8	Nov	+ 0.4	Q3	na	na	98.7	99.2	46.3	43.9	65.4	40.2	34.6	5.3
New Zealand	+ 0.4	Dec	− 0.2	Q3	na	na	82.1	79.6	2.39	2.33	3.39	2.08	1.79	1.3
Norway	+ 25.5	Dec	+ 24.0	Nov	na	na	97.7	93.1	8.96	8.96	12.7	7.79	6.71	14.3
Portugal	− 13.9	Oct	− 10.4	Nov	na	na	89.0	89.5	230	218	325	200	172	-1.7

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate. §Now using euro only. **Corrected.

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Exchange-rate forecasts

Feb 14th 2002
From The Economist print edition

Exchange-rate forecasts

from J.P. Morgan Chase
Currency units per $

	Feb 13th	3-month	12-month
Euro area*	0.87	0.90	0.92
Japan	133	138	136
Australia	1.97	1.83	1.70
Britain†	1.43	1.45	1.47
Canada	1.59	1.56	1.49
Denmark	8.52	8.28	8.10
Sweden	10.58	9.86	9.48
Switzerland	1.70	1.68	1.67
China	8.28	8.27	8.23
Singapore	1.83	1.82	1.78
South Korea	1,315	1,317	1,281
Brazil	2.43	2.53	2.51
Mexico	9.06	9.33	9.79
Poland	4.19	3.78	3.77
Russia	30.9	32.1	33.7
South Africa	11.51	12.64	13.98

*$ per € †$ per £

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Overview

Feb 14th 2002
From The Economist print edition

Inflationary pressures are rising in Latin America. The floating of the bolivar in **Venezuela** on February 13th may increase inflation, which was 12.3% in the year to January. In **Brazil**, inflation rose to 9.8% over the same period.

Inflation is even higher in **Russia**, where consumer prices jumped by 3.1% in January, the biggest increase in three years. The 12-month rate edged up to 19.2%.

There were mixed signals over industrial production. In **Malaysia**, output picked up by 2.1% in December, although this still left it 7.7% lower than a year earlier. However, in **Mexico**, industrial production fell in December for the 11th successive month, leaving it 3.6% lower than a year previously.

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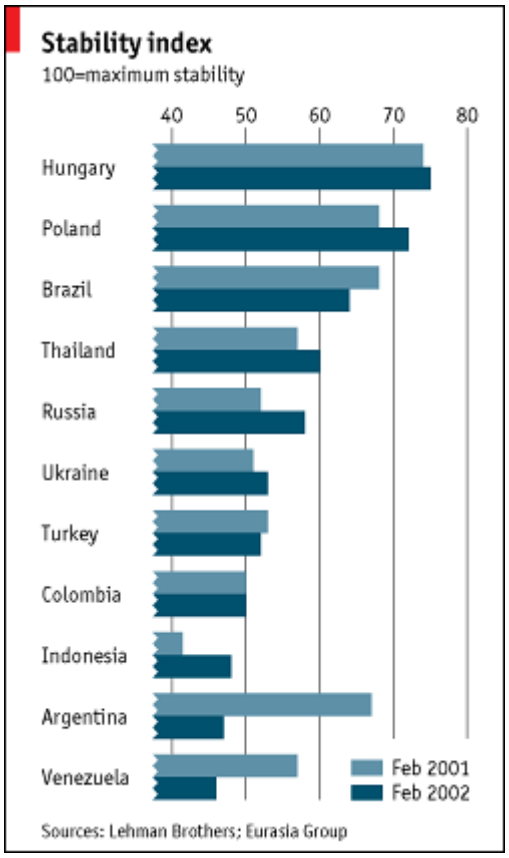
Stability index

Feb 14th 2002
From The Economist print edition

Hungary and Poland are among the most stable emerging economies, according to an index produced by Lehman Brothers and Eurasia Group, a firm that analyses political risk. The index tries to measure a country's ability to withstand (and avoid generating) crises. It includes political (60%) and economic factors (40%). The higher the index, the more stable the economy. Both Hungary and Poland score over 70. Argentina scores only 47 this year; in February 2001 it scored 67. Venezuela's score has also fallen over the past year, from 57 to 46. Russia, however, has become more stable, scoring 58 this year.



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Economy

Feb 14th 2002
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.0	Q3	+ 8.7	Dec	– 0.3	Dec	+24.1	Jan	+20.5	2000	211.8	Nov
Hong Kong	– 0.3	Q3	– 7.1	Q3	– 1.2	Dec	–11.2	Dec	+ 8.8	Q3	111.3	Jan
India	+ 5.3	Q3	+ 1.6	Dec	+ 5.2	Dec	– 5.8	Dec	– 0.7	Q3	46.4	Jan
Indonesia	+ 3.5	Q3	+ 3.2	Q2	+14.4	Jan	+25.1	Dec	+ 3.8	Q3	27.3	Dec
Malaysia	– 1.3	Q3	– 7.7	Dec	+ 1.2	Dec	+14.0	Dec	+ 7.4	Q3	30.5	Dec
Philippines	+ 3.8	Q4	– 5.0	Nov	+ 3.8	Jan	+ 3.4	Nov	+ 5.0	Oct	14.0	Jan
Singapore	– 7.0	Q4	–22.1	Dec	– 0.6	Dec	+ 5.2	Dec	+22.1	Q3	75.3	Jan
South Korea	+ 1.8	Q3	+ 3.3	Dec	+ 2.6	Jan	+ 9.5	Jan	+ 9.9	Nov	104.3	Jan
Taiwan	– 2.7	Q4	– 6.1	Dec	– 1.7	Jan	+17.5	Jan	+16.2	Q3	123.6	Jan
Thailand	+ 1.5	Q3	+ 1.3	Dec	+ 0.8	Jan	+ 2.5	Dec	+ 6.2	Dec	32.4	Dec
Argentina	– 4.9	Q3	–18.3	Dec	+ 0.6	Jan	+ 6.3	Dec	– 6.8	Q3	14.6	Dec
Brazil	+ 0.3	Q3	– 6.1	Dec	+ 9.8	Jan	+ 3.3	Jan	–23.2	Dec	35.8	Dec
Chile	+ 2.6	Q3	– 1.9	Dec	+ 2.2	Jan	+ 1.4	Dec	– 1.7	Q3	14.2	Dec
Colombia	+ 1.0	Q3	– 4.3	Nov	+ 7.4	Jan	+ 0.5	Nov	– 1.2	Q3	10.3	Dec
Mexico	– 1.6	Q3	– 3.6	Dec	+ 4.8	Jan	– 9.7	Dec	–16.6	Q3	44.7	Dec
Peru	+ 3.0	Q4	– 4.2	Nov	– 0.8	Jan	– 0.1	Nov	– 1.4	Q3	8.8	Nov
Venezuela	+ 2.8	Q3	+ 7.9	Oct	+12.3	Jan	+13.0	Q3	+ 4.4	Q4	9.4	Nov
Egypt	+ 4.6	2000†	+ 9.4	2000†	+ 2.2	Nov	– 8.5	Sep	nil	Q3	13.3	Nov
Israel	– 2.7	Q3	– 9.6	Nov	+ 1.4	Dec	– 7.0	Jan	– 3.6	Q3	23.1	Jan
South Africa	+ 0.1	Q3	+ 5.4	Dec	+ 4.6	Dec	+ 4.1	Dec	+ 0.3	Q3	6.0	Dec
Turkey	– 7.1	Q3	– 9.4	Dec	+73.2	Jan	–11.3	Nov	+ 0.9	Oct	18.9	Dec
Czech Republic	+ 3.2	Q3	+ 7.0	Dec	+ 3.7	Jan	– 3.1	Dec	– 2.6	Q3	14.5	Jan
Hungary	+ 3.7	Q3	+ 1.6	Dec	+ 6.8	Dec	– 1.6	Dec	– 0.5	Dec	10.3	Jan
Poland	+ 0.8	Q3	– 4.8	Dec	+ 3.6	Dec	–11.7	Dec	– 7.0	Dec	25.7	Dec
Russia	+ 4.9	Q3	+ 2.6	Dec	+19.2	Jan	+49.7	Dec	+41.5	Q3	32.3	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 7.7	Sep	+ 2.6	Dec	– 1.0	Nov	+ 0.3	2001†	3.6	Dec
Saudi Arabia	+ 4.5	2000§	na		nil	Nov	+50.9	2000	+15.6	2000	17.6	Dec

*Excluding gold, except Singapore; IMF definition. †Year ending June. § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Feb 14th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 13th		Dec 31st 2000	
	Feb 13th	year ago	Feb 13th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.8	na	1,571.1	+1.4	– 28.3	– 28.3
Hong Kong	7.80	7.80	11.2	2.00	10,832.7	+2.3	– 28.2	– 28.2
India	48.7	46.6	69.6	6.34	3,519.9	+2.7	– 11.4	– 15.0
Indonesia	10,188	9,603	14,584	17.59	436.8	–2.1	+ 4.9	– 0.4
Malaysia	3.80	3.80	5.44	3.28	710.9	–0.6	+ 4.6	+ 4.6
Philippines	51.4	48.0	73.5	7.74	1,388.6	+1.5	– 7.1	– 9.6
Singapore	1.83	1.75	2.62	0.94	1,740.6	–0.5	– 9.7	– 14.3
South Korea	1,315	1,252	1,883	4.55	739.7	–0.3	+ 46.6	+ 41.0
Taiwan	35.0	32.3	50.1	2.60	5,926.1	nil	+ 24.9	+ 18.0
Thailand	43.8	42.4	62.7	2.38	362.0	+4.0	+ 34.5	+ 33.2
Argentina	1.91**	1.00	2.74	na	385.2	–18.3	– 7.6	– 51.7
Brazil	2.43	1.99	3.48	19.05	12,960.7	+1.7	– 16.9	– 33.3
Chile	674	560	965	4.62*	5,269.0	+0.3	+ 8.2	– 7.9
Colombia	2,317	2,243	3,317	10.87	1,123.8	–0.4	na	na
Mexico	9.06	9.73	13.0	8.21	6,715.6	–2.2	+ 18.8	+ 26.0
Peru	3.48	3.53	4.97	2.81	1,264.6	–0.3	+ 4.7	+ 6.2
Venezuela	991	703	1,418	27.02	6,692.5	+7.5	– 1.5	– 30.4
Egypt	4.63	3.88	6.63	7.23	5,173.8	+0.9	– 32.5	– 43.3
Israel	4.65	4.10	6.65	2.22	420.7	–3.7	– 14.9	– 26.0
South Africa	11.5	7.89	16.5	10.30	10,870.9	+1.7	+ 30.6	– 14.1
Turkey	1,350,000	683,085	1,932,660	54.00	11,826.9	–3.5	+ 25.3	– 37.8
Czech Republic	36.3	37.6	52.0	4.31	408.1	–1.3	– 14.7	– 11.7
Hungary	279	289	399	8.70	7,878.5	+1.4	+ 0.4	+ 1.7
Poland	4.19	4.09	5.99	10.67	15,437.6	–0.6	– 13.5	– 14.6
Russia	30.9	28.7	44.2	25.00	295.9†	+1.1	+122.5	+106.5
EMF (MSCI)‡	1.00	1.00	1.43	na	327.8	+0.1	na	– 1.8
EMBI+§	1.00	1.00	1.43	na	208.7	+1.4	na	+ 3.4

*Inflation adjusted. †In $ terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus. **Fixed official rate 1.40.

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